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Killing A Mocking Burd And Other NJ Duty To Defend Issues

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Since the Supreme Court of New Jersey's 1970 decision in Burd v. Sussex Mutual Insurance Co., 56 N.J. 383 (1970), insurers have steadily eroded their duty to defend obligation under commercial general liability policies to a far less valuable duty to reimburse.

The time has come for insureds and the New Jersey judiciary to recognize that Burd is a lame duck. The duty to defend is a critical component of a CGL policy — often more important than the duty to indemnify — because it guarantees that insureds will have the financial ability to effectively defend themselves against claims. The current trend in New Jersey, however, has insurers holding the duty to defend hostage — citing Burd or threatening to pull coverage or withdraw from cases at a time when insureds are at their most vulnerable. This tactic denies insureds' their contractual rights and dramatically erodes the value of the modern CGL policy.

Duty to Defend in CGL Policies

In New Jersey, an insurer must provide a policyholder with a defense against any claims that are potentially (not even actually) covered by the policy. Abouzaid v. Mansard Gardens Associates LLC, 207 N.J. 67 (2011). Accordingly, an insurer's duty to defend is triggered whenever a complaint filed against an insured contains allegations that may be covered by the terms of the policy. Voorhees v. Preferred Mut. Ins. Co., 128 N.J. 165 (1992).

In the vast majority of jurisdictions, when a policyholder tenders a claim to an insurer that may or may not fall within the scope of coverage, the insurer must honor its duty to defend. Typically, the insurer will provide its insured with a complete defense subject to a reservation of rights to deny coverage for the claim at a later date, appoint independent counsel and pay the insured's defense costs until the coverage issue is resolved.

In Burd, the New Jersey Supreme Court adopted a unique approach to defining an insurer's duty to defend in a narrow set of circumstances. Under Burd, when an insurer asserts a defense to coverage that depends on facts that will not be decided in the underlying case, the duty to defend transforms into a duty to reimburse. The carrier need not provide its insured with independent counsel and may defer payment of its insured's defense costs until the coverage issue is resolved. At the end of the underlying action, the insurer may then assert any policy defenses to coverage. Accordingly, the Burd regime forces

a policyholder to either (a) wait until the end of the underlying action to initiate a coverage action against its insurer to recoup its defense costs or (b) file a declaratory judgment at the outset of the underlying litigation on the coverage issue. Neither of these options offers an insured the benefit of its contractual bargain — a defense for which it has paid its insurer premiums.

Recognizing that insurers were using Burd to rewrite the unambiguous defense obligations contained in their policies, two subsequent decisions from the New Jersey Supreme Court have shifted New Jersey away from the duty to reimburse model and brought the scope of the duty to defend back in line with that found in other jurisdictions.

In Flomerfelt v. Cardiello, 202 N.J. 432 (2010), the Supreme Court held that "in circumstances in which the underlying coverage question cannot be decided from the face of the complaint, the insurer is obligated to provide a defense until all potentially covered claims are resolved." This language directly contradicts the timing of an insurer's coverage obligation under Burd's duty to reimburse model; rather than the duty to defend not attaching until the coverage issue is resolved, under Flomerfelt, the obligation to provide a defense attaches at the outset of litigation so long as the allegations of the complaint are potentially covered by the policy terms. As the Flomerfelt court explained, "[t]he duty to defend ... is not dependent upon whether there is a finding that the claim is covered; instead it attaches because ... there are potentially covered claims."

Similarly, in Abouzaid, the Supreme Court reiterated that "potentially coverable claims require a defense." Moreover, the court clarified that the duty to defend analysis "is not necessarily limited to the facts asserted in the complaint." Rather, "an insurer's duty to provide a defense may also be triggered by facts indicating potential coverage that arise during the resolution of the underlying dispute." Thus, according to the Abouzaid court, the duty to defend will attach, even when it is uncertain whether a claim falls within the scope of the indemnity coverage, as long as there is "a potential for plaintiffs to prove a covered claim."

Without a decision explicitly overruling Burd, however, policyholders still struggle to force their insurance companies to get their defense obligation ducks in a row. This problem is causing real harm to insureds. For example, if an insured must wait until the conclusion of the underlying litigation to seek reimbursement of defense costs, it will incur the upfront costs of defending against the suit and then make a business decision as to whether pursuing a coverage claim against its insurer is worthwhile. In addition, though an insured may pursue a declaratory judgment action at the outset of a coverage dispute, the declaratory judgment is a simultaneous action in which the insured must employ legal strategy that conflicts with its defense in the underlying litigation. The insured must essentially admit that it is liable for the claims in the underlying case in order to prove the insurer's coverage obligation. In the underlying action, however, the insured must still dispute liability for these same claims, lest it not be entitled to coverage. Even if the insured is successful in the declaratory judgment action, it may increase its insurer's indemnity obligation in the underlying case, potentially beyond the limits of the policy. Finally, many insureds are reluctant to open a new front of litigation, which they must also initially fund entirely out of pocket, while self-defending the underlying action. Make no mistake, the time and financial commitments of simultaneous litigation are significant.

Right to Control the Defense When Insurer Defends Under a Reservation of Rights

Insurers rarely provide their insureds with an outright defense. Rather, insurers will offer a defense subject to a reservation of rights, allowing them to assert specific coverage and policy defenses later in litigation. Because an insurer's primary motivation is to avoid its indemnity obligation, defense counsel

paid for by an insurer ultimately has a divided loyalty. On the one hand, defense counsel owes a duty of absolute loyalty to the insured. On the other, defense counsel may be tempted to take some instruction regarding the defense from the insurer in an effort not to ruffle the insurance companies' feathers, thereby killing the proverbial golden goose.

A. Appointing Defense Counsel

An insurer that accepts an insured's claim for coverage and assumes its insured's defense outright is entitled to control the defense under its policy. Griggs v. Bertram, 88 N.J. 347 (1982). Since the insurer ultimately will be responsible for paying any resulting judgment or settlement, this right to control the defense includes the "right to select and direct counsel" as well as the "right to change counsel." 3 Jeffery E. Thomas, New Appleman on Insurance Law Library Edition § 16.04[1] (2014). When a carrier offers to defend subject to a reservation of rights, however, a conflict arises between the insurer and insured. Because of the possibility that the insurer will not have to pay a settlement or judgment if the coverage issue is resolved in its favor, the right to control the defense shifts to the insured. Morrone v. Harleysville Mut. Ins. Co., 283 N.J. Super. 411 (App. Div. 1995). However, because the insurer must still pay for the policyholder's defense in the interim, a question arises over who is entitled to select the insured's counsel: Does the insurer appoint independent counsel or can the insured select its own representation? Notwithstanding Burd's deferred payment scheme, in New Jersey, if an insured rejects its insurer's offer to defend subject to a reservation of rights, it will be permitted to select its "own counsel, subject to the carrier's approval." Dunne v. Fireman's Fund Am. Ins. Co., 69 N.J. 244 (1976).

B. Retaking Control of an Insured's Defense Late in Litigation

When an insurer defends under a reservation of rights, the issue of control over the defense can resurface later in litigation. For example, an insurer may initially allow the policyholder to select independent counsel but then later withdraw its reservation of rights and agree to assume the defense outright. In this situation, the insurer will often pressure the insured to abandon its own counsel and have its defense assumed by counsel of the insurer's choosing. Insureds will typically push back on this request, especially when counsel has already invested significant time on a matter. Though no New Jersey court has addressed this issue, decisions from other jurisdictions suggest that a carrier may be prevented from retaking control of a policyholder's defense if the insured would be prejudiced by having to switch to alternate counsel.

For example, in Swanson v. State Farm Gen. Ins. Co., 162 Cal. Rptr. 3d 477 (Cal. Ct. App. 2013) the California Court of Appeal recognized the general rule that an insurer may retake control of litigation once a disqualifying conflict of interest is removed, but clarified that an insurer's decisions to withdraw its reservation of rights, take control of the defense and cease paying independent counsel, as well as the timing of these decisions, are "subject to the insurer's duty of good faith and fair dealing to its insured." Thus, under Swanson an insurer cannot retake control of litigation and appoint new counsel unless its withdrawal is timely and it has a valid business justification for withdrawing the reservation.

Similarly, in Haley v. Kolbe & Kolbe Millwork Co. (W.D. Wis. Apr. 1, 2015), the District Court for the Western District of Wisconsin held that a carrier can be "estopped from requiring an insured to make a prejudicial change in the middle of a lawsuit." The court observed that such prejudice may exist where independent counsel has "already invested significant time and resources into the case." Because the insured's independent counsel had already engaged in extensive discovery and formulated a litigation strategy, the court found that forcing the policyholder to switch to new representation would "jeopardize the work that [its] counsel had done up to that point or at least cause significant delays as

new counsel attempted to get up to speed."

Advice for Policyholders

It is important for policyholders to understand the arguments that will allow them to obtain the defense coverage they have paid for under their policies. Though insurers may attempt to leverage Burd, the case law demonstrates that policyholders are entitled to independent counsel at the outset of litigation, and need not wait for a defense until after the issue of coverage is resolved. Moreover, policyholders cannot be forced to abandon their independent counsel later in litigation simply because the insurer decides to assume the defense. The decision to switch counsel later in litigation must be a business decision that is in the best interests of the insured and one that will not compromise its defense.

To be clear, New Jersey desperately needs its Supreme Court to expressly overrule Burd. That will require policyholders to bring declaratory judgment actions on the duty to defend and seek interlocutory appeal if that motion is denied. Or perhaps a judge will grant the motion and force an insurance company to seek appellate review. Either way, until this issue gets back to the Supreme Court, Burd will remain an albatross around the collective necks of New Jersey insureds.

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