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INSURANCE LAW

Major Developments in 2016 to NJ Insurance Coverage Law

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This year, we witnessed two major New Jersey Supreme Court decisions in insurance coverage disputes, one favorable to policyholders and the other averse. The policyholder-friendly decision addressed a hotly disputed issue in construction insurance law, while the one favorable to insurance companies imposed unexpected requirements on policyholders to report claims. The Appellate and Law Division decisions discussed below similarly represent major changes in or clarifications of the law that affect every practitioner.

Late Notice

Templo Fuente De Vida Corp. v. National Union Fire Ins. Co. of Pittsburgh is a harsh late notice decision arising out of a claims-made policy. 224 N.J. 189 (2016). The policy contained a condition stating that the policyholder must provide notice of a claim "as soon as practicable," a common provision in both claims-made and occurrence-based policies. In *Templo Fuente*, the policyholder gave notice of a claim six months after receipt. The policyholder gave notice within the policy period, as required by the policy.

The Supreme Court held that the policyholder did not have coverage. The court found that the unexplained six-month delay meant that notice was not given "as soon as practicable." To the great surprise of the policyholder bar, the court did not require the insurance company to demonstrate appreciable prejudice from the delay. The "prejudice" requirement is well-established in New Jersey in the context of general liability policies. The court, though, drew a sharp distinction between occurrence-based and claims-made policies.

Templo Fuente demonstrates that companies, counsel and insurance professionals must put a premium on providing notice of claims immediately. When a company receives a claim, insurance frequently is not its first priority. The company is busy analyzing the claim and arranging for counsel. Insurance is often relegated to a secondary consideration, particularly because of the well-known prejudice standard for general liability policies. That must now change.

Construction Insurance

The New Jersey Supreme Court affirmed the Appellate Division's pro-policyholder decision in *Cypress Point Condo. Ass'n v. Adria Towers*, confirming broad coverage for construction defects. 226 N.J. 403 (2016). The Appellate Division had reversed the trial court decision that denied coverage. The Supreme Court of New Jersey affirmed the Appellate Division and found the coverage was appropriate.

The underlying facts of this case are, sadly, very typical. Roof, façade and window construction defects caused water infiltration to owners' units and common areas. The association sued the developers and several subcontractors. One of the developers sued its insurance company, Evanston, which denied any obligation, resulting in the coverage action. It is noteworthy that the association sued under four consecutive insurance policies in place during the four years of construction. Moreover, Evanston then sued another insurance company for contribution. Thus, *sub silentio*, the Supreme Court acknowledged that the continuous trigger theory of insurance coverage applied not just to toxic tort and environmental actions, but also to construction defects.

Evanston asserted that there was no coverage because there was no occurrence, which was defined in relevant part as an accident, and no property damage. Evanston asserted that since there was no occurrence, the court could not reach the exclusions, and particularly the subcontractor exception to the "your work" exclusion. As noted, the trial court adopted these arguments, and the Appellate Division reversed.

The Supreme Court affirmed the Appellate Division and held that the association's claims of consequential water damage resulting from defective workmanship performed by subcontractors constitutes both an "occurrence" and "property damage" under the terms of the policies. The policies defined an "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." *Id.* at 425. The term "accident" was undefined by the policies, but the court found that the term "encompasses unintended and unexpected harm caused by negligent conduct." *Id.* at 427. Applying that definition, the court ultimately found that "consequential harm caused by negligent work is an 'accident.'" Therefore, because the result of the subcontractors' faulty workmanship here—consequential water damage to the completed

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and nondefective portions of Cypress Point—was an "accident," it is an "occurrence" under the policies and is therefore covered so long as the other parameters set by the policies are met.

What is a Claim?

S.M. Electric v. Torcon, is also of interest in this regard. No. A-0846-15T3, 2016 N.J. Super. Unpub. LEXIS 2289 (App. Div. Oct. 19, 2016). In this case, Torcon, a construction manager, received a letter in 2008 from S.M. Electric, its subcontractor. The letter was entitled "A Request for Equitable Adjustment," and sought $15,337,068 as further compensation on the project for the cost of additional work. Torcon, which had a claims-made policy, did not give notice of this request to its insurance company. Torcon did not pay, and S.M. Electric filed suit in 2010. Torcon then gave notice to its insurance company, which denied coverage, asserting that the claim was first made against Torcon in 2008. The trial court agreed, and the Appellate Division affirmed. Thus, a policyholder on a claims-made policy must not only give notice of a claim promptly to its insurance company, it must give notice of anything that even smells like a claim.

What is a Suit?

In *Cooper Indus. v. Employers Insurance of Wausau*, the Superior Court of New Jersey considered whether a potentially responsible party letter constituted a "suit" pursuant to the insurance policy, thereby triggering an insurance company's duty to defend. 2016 N.J. Super. Unpub., LEXIS 2003 (Law Div. Aug. 30, 2016). The court in *Cooper* considered general liability policies written before 1986, which obligated the insurer to defend the policyholder against a "suit." In contrast to many policies today, "suit" was not defined in the pre-1986 policies. As a result, the court needed to address whether the potentially responsible party letter received by the policyholder from the United States Environmental Protection Agency was a "suit."

The court in *Cooper* began by noting that the majority of the many jurisdictions that have ruled on this issue have ruled in favor of the policyholder. The court next analyzed the negative consequences to the policyholder if it failed to respond to the PRP letter. The court found that the PRP process was the only forum available to the policyholder to contest its liability, and concluded that the PRP letter was sufficiently coercive to constitute a "suit." This ruling broadens insurance companies' duty to defend in New Jersey. In view of the many "long-tail" environmental and toxic tort cases in New Jersey, this holding should have an immediate and lasting impact.

The Duty to Defend

Cooper also addressed the *Burd* issue that has haunted policyholder lawyers for decades. In *Burd v. Sussex Mutual*, the New Jersey Supreme Court essentially held that if a case contained two counts, one covered and one not covered by insurance, and that case would not resolve the issue of which count controlled, the duty to defend (paying defense expenses as they arise) became a duty to reimburse (paying after the fact if coverage was found). 56 N.J. 383 (1970). This holding placed New Jersey at odds with the other 49 states, all of which hold that the insurance company must defend as long as there is one potentially covered count. *Burd* constitutes a major anomaly in New Jersey insurance law, a constant thorn in the side of the policyholder bar.

Cooper essentially held the New Jersey Supreme Court decision in *Flomerfelt v. Cardiello*, sub silentio overturned *Burd*. In *Flomerfelt*, a girl was physically injured by a combination of drugs and alcohol. 202 N.J. 432 (2010). The insurance policy excluded injury from drugs, but not from alcohol. Instead of applying *Burd* and holding that the duty to defend became a duty to reimburse, the *Flomerfelt* court ordered the insurance company to defend until no potentially covered allegations remained in the case. *Cooper* followed *Flomerfelt*, and ordered the insurance company to defend. It will be interesting to see if *Cooper* prevails on appeal.

Allocation

Ward Sand & Materials Co. v. Transamerica Ins. Co. put to rest a long-disputed issue in New Jersey allocation. No. A-1479-13T1, 2016 N.J. Super. Unpub. LEXIS 59 (App. Div. Jan. 12, 2016). *Owens-Illlinois v. United Ins. Co.* selected a pro rata approach for New Jersey allocation law. 138 N.J. 437 (1994). It did so because it wanted to encourage New Jersey companies to purchase insurance in every year. Many policyholders faced with long-tail liabilities found themselves with less than full coverage because insurance companies that had insured them had become insolvent or otherwise. Normally, in a pro rata state, the policyholder is responsible for such gaps in coverage. Policyholders in New Jersey argued that *Owens-Illinois* was an equitable decision designed to encourage the purchase of insurance. Thus, companies that purchased insurance only to have the insurance company become insolvent should not be penalized by the imposition of the share of that insolvent insurance company. The Appellate Division disagreed, and held for the application of full pro rata allocation.

Property Damage

Phibro v. National Union Fire Ins. Co., 446 N.J. Super. 419 (App. Div. 2016) (the authors' firm, Anderson Kill, represents Phibro in this case) concerned a feed additive for chicken feed that resulted in chickens not gaining weight. Phibro sold a feed additive to chicken producers that was supposed to prevent a certain disease. While the additive worked, it also prevented the chickens from gaining weight, so that they were the wrong size for the chicken processors and could not be used. This resulted in claims against Phibro. Phibro sued National Union for coverage under its commercial general liability policy. The trial court granted summary judgment to National Union, finding that there was no property damage.

The Appellate Division reversed. It found that the change in the chickens' physical condition constituted property damage. Alternatively, the court found that the inability to utilize the chickens satisfied the "loss of use" prong of the policy's definition of property damage. The decision in *Phibro* is consistent with New Jersey's history of reading the term "property damage" broadly.

Conclusion

These decisions illustrate the case-by-case approach taken by the New Jersey courts in 2016, making it difficult to label the state as pro-policyholder or pro-insurance company. The decision denying coverage in *Templo Fuente* surprised many insurance practitioners, while *S.M. Electric* underscores the critical importance of proper notice. While the pro-insurance company ruling in *Ward Sand & Gravel* may be less of a surprise, it still disheartened policyholders. At the same time, the courts issued a number of rulings favorable to policyholders on highly disputed issues. If 2016 is any guide, it is becoming increasingly difficult to determine how New Jersey courts will rule on insurance issues.■