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INSURANCE LAW

Courts Reaffirm Pro-Policyholder Insurance Principles in 2019

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Sosa v. Massachusetts Bay Ins. Co., 438 N.J. Super. 639 (App. Div. 2019), concerned a water main break. The water flowed over the surface and entered the policyholder's basement. The insurance company relied upon a flood and surface water exclusion to deny coverage. In support of the flood part of the exclusion, the insurance company pointed to testimony from the policyholder that "there was a flood and there was damage to my home."

The court disagreed. It looked at case law from other jurisdictions and definitions indicating that a flood is "a general and temporary condition of partial or complete inundation of normally dry land areas."

The insurance company next looked to the surface water exclusion to deny coverage. The Appellate Division also rejected this argument. It found that the policy did not define "surface water," and looked both to dictionary definitions and the definition of surface water in DEP regulations to hold that the term was ambiguous. As a matter of law, it construed the ambiguity in favor of coverage.

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The insurance company further relied upon a sump exclusion that was in a provision entitled "Water Back-up and Sump Discharge or Overflow." Again the court rejected, stating that "we question whether the insurer may invoke a general amendment to the water damage exclusion that is buried in an endorsement …. Insurers are not free to subject policyholders to 'hidden pitfalls' that violate the insured's reasonable expectations."

Ambiguity and reasonable expectations are the bedrock of New Jersey insurance law. Policyholders should always look to employ these principles when their insurance companies deny coverage. In particular, numerous courts across the country have found coverage in recent years on the basis of ambiguity. Often the ambiguity may not be self-evident. Policyholder counsel must creatively review the facts of the case in light of the insurance policy language to determine if an ambiguity exists.

C.M.S. Investment Ventures v. American European Ins. Co., No. 2056-17T3 (N.J. App. Div. 2019), concerned a tenant suing a landlord as a result of an assault in her apartment. The insurance company relied upon an assault and battery exclusion to deny coverage. The trial court held that the exclusion was ambiguous, "capable of limitless meaning." The Appellate Division did not address that issue. It held instead that since the underlying complaint alleged negligent maintenance of the premises, the insurance company had to defend. The court further held that since the insurance company delayed 20 months in denying coverage, it was estopped from denying coverage.

Finally, the court awarded the policyholder its attorney fees in defending the underlying action. The trial court had used a lodestar rate of $350 per hour, while the insurance company maintained that it could have retained counsel for $190. The court rejected the insurance company's position that the rate of $190 should apply, reasoning that insurance companies had special relationships with law firms that were unavailable to policyholders and that allowed the insurance company to receive lower rates.

Policyholders often find themselves in the situation where they are forced to retain counsel to protect their interests while waiting for a coverage decision from their insurance companies. *C.M.S.* is an important weapon in such cases for policyholders to recover their attorney fees in full at the rates which they paid, and not on the basis of what an insurance company could have charged. The policyholder should not be penalized for the insurance company's delay.

The Southern District of New York applied New Jersey law to provide a ringing endorsement to New Jersey waiver and estoppel insurance law. *RLI Ins. Co. v. AST Engineering Group,* 2019 U.S. Dist. LEXIS 220582 (S.D.N.Y. Dec. 20, 2019). This is the rare case where bad facts produced good law (for the policyholder). The case involved a claims-made professional liability insurance policy that had a retroactive date of March 22, 2013. The underlying claim arose prior to that date. The insurance company agreed to defend but did not issue a reservation of rights letter for over 30 months. The court found that this delay was "unreasonable and presumptively prejudicial." The court then held that RLI in its reservation of rights letter had failed to advise its policyholder that it could accept or reject the representation that RLI offered, as required by New Jersey law. As a result, the court struck RLI's coverage defenses.

Additionally, RLI sought to amend its answer to assert that

the policyholder had procured the insurance policy fraudulently. The court denied this request—even though it later found that the policyholder did act fraudulently. It found that RLI had knowledge of the fraud when it agreed to defend, and had therefore made an election of remedies that waived its right to later rely on the fraud to disclaim coverage. The court's application of estoppel and waiver followed well-established New Jersey insurance principles. *Merchants Indem. Corp. v. Eggleston,* 37 N.J. 114 (1962); *Griggs v. Bertram,* 88 N.J. 347 (1982). However, case law has not addressed these rules in recent years. *RLI v. AST Engineering* provides a much-needed affirmation of the continuing vitality of these principles.

In *New Jersey Transit Corp. v. Lloyd's*, the Appellate Division affirmed a trial court holding that New Jersey Transit's losses stemming from Superstorm Sandy were not subject to its insurance policy's $100 million sublimit for flood, but instead "the full $400 million policy limits for the Sandy-related water damage" would be available. Nos. A-1026-17T1 & A-1027-17T1, slip op. at 3 (Nov. 18, 2019). The court found that Superstorm Sandy qualified as a "named windstorm" under the applicable policy language, which included wind-driven rain, storm surge, and associated flood or water damage. The court's holding rested primarily on two grounds. First, the court held that while "[t]he policies do not define 'flood' to include 'storm surge' and 'wind driven water' associated with such a 'named windstorm,'" and "[a]lthough the definition of 'flood' includes 'surge,' the definition of 'named windstorm' more specifically encompasses the wind driven water or storm surge associated with a 'named windstorm.' Where, as here, two provisions of an insurance policy address the same subject, 'the more specific provision controls over the more general.'" *Id.* at 14-15 (citation omitted).

Second, the court concluded that even if New Jersey Transit's "losses were caused by both a 'flood' and a 'named windstorm,' it would nevertheless be entitled to coverage under New Jersey's efficient proximate cause doctrine." *Id.* at 22. Specifically, the court opined that New Jersey employs "Appleman's Rule," under which "if an exclusion 'bars coverage for losses caused by a particular peril, the exclusion applies only if the excluded peril was the 'efficient proximate cause' of the loss.'" *Id.* at 23 (citation omitted). Further, "[b]ecause Sandy's 'storm surge' caused, 'in an unbroken sequence,' any losses that might otherwise not be covered under the flood sublimit, the storm surge is 'regarded as the proximate cause of the entire loss.'" *Id.* (citation omitted). The Appellate Division's holding was a critical re-affirmance of important rules of insurance policy interpretation under New Jersey law. It should help guide future disputes and assist policyholders in maximizing their insurance recoveries. ■