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Recent New Jersey Supreme Court Decision Constricts an Insurance Company's Duty to Defend

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Key points:

The New Jersey Supreme Court recently may have narrowed insurance companies' duty to defend under very specific circumstances — when the coverage issue is irrelevant to the underlying suit.

Insurance companies are likely to interpret this exception broadly and deny defense more often.

Policyholders should move swiftly to establish the duty to defend prior to discovery.

A recent New Jersey Supreme Court decision, *Norman International, Inc. v. Admiral Insurance Company*, is likely to be interpreted by insurance companies as narrowing the duty to defend when coverage cannot be immediately ascertained from the complaint.

Typically, when a third-party plaintiff files a lawsuit against a policyholder, and it is unclear from the third-party complaint whether there is coverage, ambiguity is resolved in favor of the policyholder, and the insurance company has a duty to defend the policyholder. This duty commences at the filing of the third-party complaint and continues until all potentially covered claims are resolved. However, the *Norman* court held that if the issue that will determine coverage is not relevant to resolution of the claims asserted in the third-party complaint, a court may look beyond what is pled in the third-party complaint to the facts of the case to determine whether there is coverage.

Insurance companies are likely to argue that by allowing a court to look beyond the complaint to determine coverage, the New Jersey Supreme Court narrowed an insurance company's duty

to defend — from requiring defense until the resolution of all potentially covered claims, to only requiring coverage until the discovery of evidence demonstrating non-coverage.

Based on this interpretation, insurance companies are likely to deny coverage at the outset of many third party lawsuits. Given that courts could potentially agree with the insurance companies' understanding of the holding in *Norman*, policyholders should pursue coverage litigation as soon as possible — *before* discovery generates concrete evidence of non-coverage —so that they may benefit from defense coverage until an insurance company obtains evidence to negate coverage.

In *Norman*, the policyholder, Richfield Window Coverings, LLC (Richfield), sold window coverings, blinds, and shades to retail sellers including Home Depot, Inc. Richfield also provided retailers with blind cutting machines to meet customer specifications. Richfield had a general liability insurance agreement with Admiral Insurance Company.

An employee of a Home Depot located in Nassau County, New York, severed her fingers while operating a blind cutting machine provided by Richfield. The employee sued Richfield, seeking compensatory damages. When Richfield notified Admiral of the lawsuit, Admiral denied coverage, contending that the policy's exclusionary clause barred claims "arising out of, related to, caused by, contributed to by, or in any way connected with any operations or activities performed by or on behalf of any insured," in certain specifically identified counties in New York, including Nassau County.

Thereafter, Richfield pursued coverage litigation in the New Jersey Superior Court. The New Jersey Superior Court ruled in Admiral's favor and the New Jersey Appellate Division reversed. The New Jersey Supreme Court in Norman agreed with the Superior Court and reversed the Appellate Division's decision.

In so holding, the *Norman* court explained that generally, the test to determine coverage is as follows: the underlying complaint should be laid alongside the insurance policy and a determination made as to whether, if the allegations are sustained, the insurance company will be required to pay the resulting judgment, with any doubts resolved in favor of the policyholder.

Then, in reliance upon its 1970 decision in *Burd v. Sussex Mutual Insurance, Co.*, the *Norman* court held that when insurance coverage depends on a factual issue that will not be resolved by trial, an insurance company's duty to defend may depend upon the actual facts and not upon the allegations in the complaint, and when such is the case, a court may look beyond the complaint to the facts to determine whether there is coverage.

Applying the *Burd* analysis to the matter at hand, the *Norman* court determined that the coverage issue was whether the employee's injury was connected to Richfield's activities in Nassau County, which is excluded under the policy; that this determination was irrelevant to resolution of the tortious claims asserted in the third-party complaint (whether there was a manufacturing defect, design defect, a failure to provide adequate warnings, and whether Richfield was negligent in causing the employee's injuries); and that therefore, the issue before the *Norman* court required consideration of facts beyond the complaint. Correspondingly, the *Norman* court looked beyond the complaint to evidence established through discovery, and determined that Richfield's activities triggered the exclusionary clause, thereby negating Admiral's duty to defend.

Following the holding in *Norman*, insurance companies may assert that while they have a day-one duty to defend, it continues only until concrete evidence is established to negate coverage. Consistent with this position, many insurance companies may deny coverage at the outset of a third-party lawsuit, as Admiral did in *Norman*. Mindful of the fact that courts could possibly agree with the insurance companies' interpretation of *Norman*, policyholders should pursue coverage litigation at the outset – *i.e.*, before discovery generates

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