

CLAIMS HANDLING- THE DOs AND DON'Ts

Claim handling in New Jersey is governed, for the most part, by case law and in some instances, by statute. These materials will provide a general overview of good claim handling practices. It will also provide some guidance on how to properly and efficiently determine if a claim is covered, how to defend under a reservation of rights and how to disclaim. Lastly, the consequences of failing to adhere to accepted claim handling procedures will be explored.

In general, “good faith” claims handling practices require:

- fair and full disclosure to the insured
- timely response
- timely notice of conflicts

By statute, Insurance trade practices are governed by the Trade Practice Act, N.J.S.A. 17:29B-1. Pursuant to 17:29B-4, there are 15 general categories of unfair practices. The prohibited practices which are of most interest include:

1. Misrepresentations of facts or policy provisions;
2. Failure to acknowledge and act reasonably in response to a claim;
3. Failure to adopt and implement reasonable standards for the prompt investigation of claims;
4. Refusal to pay claims without conducting a reasonable investigation based upon available information;
5. Failure to affirm or deny coverage within a reasonable time period;
6. Failure to promptly and fairly settle claims once liability becomes clear;
7. Paying substantially less to an insured for a claim, compelling the insured to initiate a declaratory action to recover amount due.

IS THE CLAIM COVERED?

First, retrieve and review a complete copy of the policy. It is important to review the declarations page to confirm that you have all coverage parts and endorsements. You will also want to be able to quote the correct policy language should you elect to defend under a ROR or disclaim.

DUTY TO INVESTIGATE

The company has an immediate duty to make a reasonable investigation to determine coverage. But there is no duty to investigate the underlying claim if the insured does not provide relevant facts concerning coverage. The Company is not required to look beyond the facts known to it and need not investigate beyond the information supplied to it. Where the available facts are insufficient to determine coverage, you may request additional information from the insured.

The Company will have a reasonable time to assess coverage provided that its actions do not prejudice the insured. Griggs 88 NJ 347. "Reasonable time" depends on the complexity of claim and the effect the delay will have on the insured. Once you have determined the Company's coverage position, you must promptly advise the insured.

IS THERE COVERAGE?

The Company cannot rely on hyper-technical or unfair interpretation of policy terms to disclaim coverage. Members of the public are entitled to an interpretation consistent with their reasonable expectations.

1. The duty to defend is triggered by a "suit". Certain EPA enforcement actions and EEOC claims are not considered "suits".
2. Do the allegations contained in complaint fall within scope of coverage? If so, even if the allegations are false, groundless or fraudulent, coverage will be triggered. The relevant issue is whether the allegations, if proven, would trigger coverage and a duty to indemnify. Do not confuse liability issues and defenses with coverage defenses. Where there are ambiguities in the complaint, they must be interpreted so as to favor a finding of coverage. In New Jersey, you can rely and must consider facts outside of the complaint to either find or deny coverage.
 - Has there been an "occurrence" or accident?
 - Has the "occurrence" resulted in "property damage" during the policy period? In some instances, the mere allegation of property damage during the policy period is not enough- there must be some actual proof, i.e. environmental contamination claims, FRT plywood claims. Keep in mind that "property damage" is defined to include "loss of use of tangible property". Economic damage or loss is generally not considered property damage.

- In determining whether the property damage or bodily injury occurred during the policy period, New Jersey courts will sometimes employ the “continuous trigger” theory in instances when it cannot be determined when the damage or injury occurred. The most notable examples are asbestos exposure and certain environmental claims. Coverage will be triggered from the date of initial exposure until the manifestation of damages to the insured. The application of the continuous trigger theory is fact sensitive.
 - Has the “occurrence” resulted in “bodily injury” during the policy period? Keep in mind that emotion distress or trauma is not considered “bodily injury” unless there is some physical manifestation of the condition.
 - Has there been a “personal” or “advertising injury” (coverage Part B) during the policy period?
 - false arrest
 - malicious prosecution
 - wrongful entry or eviction
 - slander/libel
 - publication of material that violates a person’s right to privacy
3. Has the insured met conditions precedent to coverage, i.e. has the insured cooperated? The insured’s disappearance before trial has been equated with “appreciable prejudice” to the insured, supporting a denial of coverage.
4. Has there been a misrepresentation of material fact in the policy application warranting rescission?

IF COVERAGE HAS BEEN TRIGGERED, IS IT OTHERWISE EXCLUDED?

Exclusions are strictly construed but cannot be disregarded where clear and unambiguous. The exclusions most typically applicable are:

- Expected or Intended Injury- was the property damage or bodily injury expected or intended from the standpoint of the insured? The subjective intent of the actor controls unless the conduct was “reprehensible” in which case intent is presumed. The intent to commit the act giving rise to the injury or damage is of no import. The “intent” of one insured cannot be imputed to another insured.
- Contractual Liability- there is no coverage for breach of contract claims. The inquiry is whether the claim arises in tort or contract. Many are both.
- Employer’s Liability- there is no coverage for bodily injury to an employee arising out of and in the course of employment. “Arising out of” is defined broadly. Bodily injury to the spouse, child, parent, brother or sister of the employee is also excluded.

- Pollution Exclusion- since 1986, most policies have contained an Absolute or Total Pollution exclusion which bars coverage for “traditional” environmental claims.
- Owned Property- there is no coverage for property damage to property owned, rented to or occupied by the insured. This includes “alienated” property. It includes personal property in the “care, custody or control” of the insured. It includes real property on which the insured or any of the insured’s contractors are performing operations if the property damage arises out of those operations.
- Damage to Your Product
- Damage to Your Work
- Bodily injury arising out of “personal and advertising injury”

OTHER COVERAGE ISSUES

- Is the damage or injury the result of a “known loss” or “loss in progress” prior to the inception of coverage? More recent GNY policy forms contain language which memorializes and supports this doctrine. Simply stated, you cannot purchase insurance coverage of a loss you are aware of or which is in progress.
- There is no coverage where the claimant seeks equitable relief.
- If questions of fact relevant to coverage remain which will not resolved in the underlying matter, there is no duty to defend. Later, if coverage is found, the Company will be required to reimburse defense costs. This is the “wait and see” approach. Recent case law establishes that the insured does not have the right to dictate the hourly rate which the Company will pay as reimbursement of defense costs under such circumstances. The Court will determine a reasonable hourly rate taking into consideration prevailing insurance defense rates and other factors.
- If defending the insured will present a conflict of interest, the Company may not undertake the defense. Again, the duty to defend may turn into a duty to reimburse. The most common example is found where the complaint contains allegations of negligence and intentional conduct or where punitive damages are sought. This conflict cannot be waived by the insured.
- Defending co-insureds, such as an owner and a property manager will often present a conflict if the two have potential cross claims against each other. Separate counsel should be assigned unless both parties agree to waive potential cross claims and the conflict. Very often, this proves not to be a problem as their interests are aligned.
- Late notice. Coverage may be disclaimed if by virtue of the late notice, there is a substantial likelihood of appreciable prejudice to the Company.

DEFENDING UNDER A RESERVATION OF RIGHTS

- There are instances where allegations of the complaint trigger coverage but facts may develop which will limit or preclude coverage. The Company has an obligation to defend and does so under a ROR.
- You must identify all claims and allegations that are not covered and you must advise the insured of all known reasons in support of this finding. The Company will be estopped from asserting a policy defense not identified in the ROR. The Company will be estopped from asserting new coverage defenses or disclaiming (absent a suitable ROR) if the insured has relied on the Company's position or action to its detriment or prejudice. Prejudice will be imputed if the company defends and continues to defend after having knowledge of facts supporting denial of coverage. Detrimental reliance or prejudice is defined, generally, as a "material encroachment upon the rights of an insured" to protect itself.
- The Company will not be estopped from denying coverage even after it interposed a defense provided the insured has not been prejudiced.
- For those claims for which the Company will not indemnify the insured, you should advise the insured of their right to retain their own counsel at their own expense. For claims for which the Company will not or cannot defend because of a conflict, you must advise the insured of their obligation to retain personal counsel. Where the Company has elected to defend all claims, covered and uncovered, you may wish to reserve the right to seek an allocation of defense costs.
- You should advise that the insured is not obligated to accept a conditional defense subject to a reservation of rights. Most insureds will usually accept the defense so as to avoid litigation costs. An acceptance may be inferred from the insured's failure to reject the company's offer to defend under a ROR.
- You should confirm that the Company will not indemnify the insured for punitive damages.
- You should advise the insured of coverage limits with reference to the policy.
- You should reserve the Company's rights generally, including the right to withdraw from the defense should facts be revealed warranting such action.
- You should advise the insured of their obligation to cooperate with assigned defense counsel.
- Where appropriate, you should advise the insured of their obligation to prevent an insurable loss or additional losses loss from occurring and to mitigate damages. This is sometimes warranted in certain mold claims and environmental claims.
- Assigned defense counsel should not be given a copy of the reservation of rights and should not be advised of coverage limitations. Should the Company not be defending all counts in the complaint, assigned defense counsel should simply be advised as to which counts to defend.

- When defending co-insureds with potential cross claims against each other, separate counsel must be assigned unless both insureds agree to waive all cross claims and any conflicts.
- You should advise the insured that the Company's coverage obligation ends when all covered claims are eliminated

DISCLAIMING COVERAGE

- Identify all reasons in support of the disclaimer. If you do not identify a particular ground for disclaiming coverage, you cannot cite to it or rely on that ground in a subsequent declaratory judgment action.
- Do not end denial with invitation to insured to provide additional information which the Company will consider. This has been found not to be a disclaimer for statute of limitations purposes.
- Advise the insured of the right to appeal the decision to the internal appeals panel and, ultimately, to the New Jersey Insurance Claim Ombudsman.

BAD FAITH

BAD FAITH IN DENYING COVERAGE

The denial of coverage, even if erroneous, will not allow a finding of bad faith provided there was a good faith belief that coverage did not lie. If the claim is “fairly debatable”, the Company’s denial of coverage will not be considered bad faith. To prevail, the insured will have to show the “absence of a reasonable basis for denying benefits of the policy and the [Company’s] knowledge and reckless disregard of the lack of a reasonable basis for denying the claim.”

BAD FAITH IN CLAIMS HANDLING AND SETTLEMENT

Both parties to the insurance contract owe the other a duty of good faith and fair dealing. However, the Company is considered the expert and is charged with protecting the interests of the insured. There are certain criteria which will be considered in determining whether the Company has acted in bad faith in representing its insured and conducting settlement negotiations. A finding of bad faith may render the Company liable for punitive damages. The criteria are:

1. The strength of the plaintiff’s liability and damage claims;
2. Whether the Company has promptly investigated the incident and claim;
3. Whether the Company has rejected the advice of assigned defense counsel;
4. The failure of the Company to keep its insured apprised of settlement negotiations;
5. The amount of financial or other risk to which the insured will be exposed if the case is not settled;
6. Whether the Company provide complete and accurate information to the insured;
7. Whether the Company attempted to coerce the insured to contribute to the settlement.

Estoppel may result from the unreasonable refusal to settle within policy limits and the Company may be responsible for a verdict in excess of its policy limits. However, a finding of bad faith is not automatic.

BY:

Michael J. Marotte, Esq.
Co-Chair, Insurance Coverage Practice Group
Schenck, Price, Smith & King, LLP
10 Washington Street
P.O. Box 905
Morristown, New Jersey 07963-0905
Direct Dial: (973) 631-7848
Email: mjm@spsk.com

March, 2006