More bad faith in New Jersey

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Last summer, after a lengthy trial, New Jersey Superior Court Judge, Robert E. Guterl concluded that the manner in which three insurance carriers investigated and considered a claim submitted by an insured constituted not only bad faith but was sufficiently "deliberate, malicious and egregious" as to warrant punitive damages. Princeton Gamma-Tech Inc. v. Hartford Insurance Group, et al., (N.J. Super. Ct. Law Div., June 5 1997).

The claim involved Comprehensive General Liability policies issued in the 1960s, 1970s and 1980s for damages resulting from environmental contamination based upon PGT's receipt of Superfund "Notice Letters" from the U.S. Dept of EPA in 1989 and 1990.

Regardless of the nature of the claim i.e. environmental, this case will surely be followed in other courts throughout the U.S. This article will examine the nature of the underwriters' ever increasing obligations to its assured.

Analysis should begin with the state Supreme Court's 1993 decision in Pickett v. Lloyd's, 131 N.J. 457, which suggests the adoption of the "fairly debatable" standard set forth by the Rhode Island Supreme Court in Bibeault v. Hanover Ins. Co., 417 A.2d 313, 319 (R.I. 1980) "a claimant who could not have established as a matter of law a right to summary judgment on the substantive claim would not be entitled to assert a claim for an insurer's bad faith refusal to pay the claim."

However, in the PGT case the court rejected the "fairly debatable" standard as too limiting because it invites abuse by the insurance industry.

Judge Guterl reasoned if the "fairly debatable" standard defined the threshold for bad faith, there would be no bad faith verdicts. If for example, an underwriter totally disregards a claim, denies a claim for spurious reasons, is abusive to the policy holder or puts the policy holder in jeopardy by refusing to accept a plaintiff's reasonable settlement offer its behaviour may defeat judicial scrutiny simply by answering a summary judgment motion with factual questions that must first be resolved, whether or not the insurer ever considered those questions in evaluating the claim.

To follow the court's decision, one should begin with the propositions that statutory and case law established an underwriter's affirmative fiduciary obligations to perform specific duties on behalf of the assured, starting with the manner in which a notice of claim is processed internally, continuing with the manner in which facts are developed to allow a decision to accept or decline coverage, and continuing after the initial coverage determination has been made. It is to those authorities, and not just the "fairly debatable" standard one must look to.

Every contract executed in New Jersey, as in all states recognizes each party's duty of good faith and fair dealing to other parties as well as its duty to honor the "spirit of the deal". Bad faith may consist of inaction and lack of diligence. Twenty-four years ago, the New Jersey Supreme Court set in motion a new and additional concept of contractual liability of underwriters for failing to meet their obligation to the assured. That "new" concept is now accepted as a universal norm.

The court stated good faith encompasses independent duties to (1) investigate the claim; (2) process the claim promptly; (3) determine honestly and fairly whether to defend or attempt to settle a claim; and (4) decide fairly whether to accept coverage. If the underwriter flatly declines to defend or cover a claim without setting forth specific and well-founded reasons for its declination, it will be subjected to bad faith claims on each ground.

That underwriters have an affirmative duty to perform a prompt, adequate investigation of a policy holder's claim is not only supported by case law going back over 20 years but is also required by the New Jersey Unfair Claims Settlement Act.

The investigation must be "objectively adequate". >

If the assured does not provide or does not have sufficient facts to enable a coverage determination, an underwriter's fiduciary duty to its assured dictates an obligation to assist in the gathering of that additional information. This view is in accord with prior cases where the court dismissed the bad faith cause of action only after finding that the underwriter had conducted an investigation which produced a basis for its decision to deny benefits.

Because the assured has paid for the protection of an underwriter's greater level of expertise and resources, so the reasoning goes that the failure to adequately investigate a claim amounts to a denial of benefits it paid for. Consequently, if an underwriter declines to defend or indemnify based upon the "possibility of an action or inaction of its assured" without first establishing whether the facts support those grounds for denial, it has failed to meet its good faith obligation to investigate.

The *Pickett* decision firmly established that a delay in processing may constitute a basis for finding bad faith even where benefits were ultimately paid. "Bad faith is established by showing that no valid reason exists to delay processing the claim and the insurance company know or recklessly disregarded the fact that no valid reasons supported the delay".

Judge Guterl concluded what *Pickett* meant was that assureds, particularly those who face potentially large liabilities, often do not have sufficient resources to appropriately respond to an accident or claim. Therefore failure to promptly process a claim within a reasonable time or repeatedly responding to the assureds communications with requests for more information automatically subjects the underwriters to the *Pickett* test for determining bad faith.

New Jersey courts at all levels have long upheld an underwriters' duty to defend under a reservation of rights until it is able to meet its burden of demonstrating no coverage. However, in PGT the defendant underwriter relied on two appellate division cases, Rutgers v. Liberty Mutual, 277 N.J. Super 571 and Trustees of Princeton v. Aetna Casualty 293 N.J. Super 296, to suggest underwriters can defer payment of the defense until disposition of the coverage case. Judge Guterl rejected that idea as inconsistant with prior New Jersey case law. "To do otherwise would allow the underwriters to turn its duty to defend into a duty to indemnify."

Thus, the Judge upheld the extra-contractual liability verdict in *Rova Farms* proclaiming the underwriters duty to assist the assured in settling a claim. So, unless there are prima facia reasons to conclude no coverage exists, deferring defense costs denies the assured access to resources that could otherwise be used, to the betterment of the assured, which the court concluded ignores ample New Jersey case law that broadly recognises the underwriters duty to defend.

Under *Pickett*, a bad faith verdict would not have been sustained if there were fairly debatable reasons supporting the underwriters declinations of coverage. PGI expands the duty to reach a fair coverage determination. The underwriter's decision to decline coverage must be based on facts, and under New Jersey law, those facts must be set forth in the underwriter's claim file. The facts used in evaluating underwriters conduct will be judged by contemporaneous facts not subsequent events.

Each of the duties appear to be interrelated but they are not! Each element must be assessed independently. The PGT case changes *Pickett* from that of "passive conduct" on the part of the underwriter to that of "affirmative action" to establish it has acted in good faith in order to defend a bad faith cause of action. The court concluded the purpose of requiring underwriters to investigate facts and apply them to the policy wording in reaching a fair and honest coverage determination insures the integrity of a system that is largely controlled by underwriters' claims personnel. In PGI the court also awarded punitive damages based upon *Pickett*, finding the underwriters conduct to be so lacking in good faith so as to constitute malicious and egregious behaviour. ○

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