NJ Supreme Court holds Insurers have Independent Right of Action against Co-Insurers for Defense Costs in Continuous Property Damage Claim

In a matter of first impression, the New Jersey Supreme Court has held that an insurer that has fulfilled its obligation to defend and indemnify an insured has a direct claim for contribution against its co-insurer for defense costs arising from continuous property damage litigation.

The Court also held that an insured's settlement with the co-insurer does not defeat the contribution claim when the insurer seeking contribution is not a party to the settlement agreement. *Potomac Ins. Co. of Illinois ex rel. OneBeacon Ins. Co. v. Pennsylvania Mfrs.' Ass'n Ins. Co.*, A-2 SEPT.TERM 2012, 2013 WL 5018577 (N.J. Sept. 16, 2013)

Case Summary

The insured was the general contractor responsible for construction of a new middle school in Evesham Township, New Jersey. The work took place over two years and was completed in 1993.

Beginning in its first year of use, the school experienced leakage and other defects, principally related to the roof. On December 20, 2001, Evesham filed an action in which it asserted claims for negligence and breach of contract against the insured general contractor, the project architect, and the construction manager and sought enforcement of a surety's obligation on a performance bond. Evesham sought compensatory damages, including remediation costs that were yet to be incurred, as well as attorneys' fees and other relief.

The insured tendered the claim to five different insurance carriers who insured it at various times during the period from 1993 to 2003—PMA, Newark Insurance, Royal Insurance, OneBeacon, and Selective, in that order. Selective and OneBeacon paid the insured's defense costs. PMA and Royal disclaimed.

The insured brought a declaratory judgment action against PMA and Royal. The insured and PMA then agreed to submit their dispute to binding arbitration. While the arbitration was pending, the insured made a demand for $270,000 to settle with PMA. That amount represented what Aristone perceived to be PMA's indemnity and retroactive defense obligations. The parties, however, were unable to agree on settlement terms, the arbitrator found that PMA had a duty under its policies to cover Aristone and share in Aristone's litigation costs, and issued an award allocating a portion of those costs to PMA.

The arbitrator's award triggered settlement discussions between insured and PMA, eventually resulting in an agreement under which PMA agreed to contribute $150,000 toward the resolution of the underlying dispute with Evesham in exchange for the insured's release of the claims against PMA. The release was executed on March 2, 2007, and released PMA from all claims, "including, without limitation, any and all claims by [the insured] concerning PMA's obligation to pay the attorneys' fees and costs incurred in defense" of the Evesham action.

The insured then settled with Evesham for $700,000. In addition to the $150,000 contributed by PMA on Evesham's behalf, OneBeacon paid $150,000, Selective paid $260,000 and Royal paid $140,000.

OneBeacon then approached PMA and Royal and demanded that they pay a share of defense costs. When PMA and Royal declined to contribute, OneBeacon sued them for reimbursement, asserting that they had failed to pay their respective shares of the insured's defense costs.

The trial court ruled in OneBeacon's favor, concluding that PMA's settlement with the insured did not prevent OneBeacon from seeking contribution for the costs incurred to defend the claim. The trial court also

apportioned the $528,868.54 in defense costs using the formula set forth by the Supreme Court in *Carter–Wallace v. Admiral Ins. Co.* , 154 N.J. 312, 712 A.2d 1116 (1998), and found PMA liable for 16 percent of the total defense costs, or $84,618.76. OneBeacon was also awarded legal fees in connection with its action against PMA. The Appellate Division affirmed.

On appeal, the Supreme Court framed the issue as follows: whether an insurer may assert, against a co-insurer, a claim for defense costs incurred in litigation that arises from property damage manifested over a period of several years, during which the policyholder is insured by successive carriers.

The Court's analysis begins with a discussion of its decision in *Owens–Illinois Inc. v. United Insurance Co*., 138 N.J. 437, 475–76, 650 A.2d 974 (1994)1, in which the Court adopted the "continuous trigger" theory of coverage in a case involving claims for asbestos-related personal injury and property damage cases and reviews the other contexts in which the continuous trigger theory has been applied. *Carter–Wallace v. Admiral Ins. Co*. , 154 N.J. 312, 712 A.2d 1116 (1998)(progressive environmental property damage); *Benjamin Moore & Co. v. Aetna Cas. & Sur. Co.*, 179 N.J. 87, 91, 110, 843 A.2d 1094 (2004)(injuries arising from ingestion of lead paint).

The Court observed that recognizing an insurer's cause of action for contribution against a co-insurer for allocation of defense costs comports with *Owens–Illinois* and its progeny. Like the obligation to indemnify the insured addressed in *Owens–Illinois* and *Carter–Wallace*, the obligation of successive insurers to pay the policyholder's defense costs can be readily determined by equitable allocation. Absent a right of contribution, a carrier that pays defense costs as they are incurred might alone bear a burden that should be shared. An inequitable allocation of the cost of defense, like an unfair allocation of the obligation to indemnify, may justify a judicial remedy.

Since the Court determined that an insurer has an independent right of contribution to seek reimbursement of defense costs paid beyond its pro rata share—as opposed to recovery on a subrogation theory—it followed that the insured's settlement of its claims against a co-insurer could not extinguish the independent contribution right of other insurers.

Observations

The opinion is perhaps as interesting for what it does not say as for what it does. The fundamental premise on which the Court's reasoning is based is that the continuous trigger theory applies to "continuous property damage" claims and this is the first case in which the Supreme Court has recognized its applicability to a construction defect case as opposed to an asbestos or pollution case. But the opinion provides no guidance as to what constitutes a "continuous property damage" claim and provides very limited information concerning the nature of damages involved (leakage and other defects, principally related to the roof). Therefore, it appears that at least in the construction defect context applicability of the continuous trigger must still be decided on a case by case basis. See e.g. *Aetna Cas. & Sur. Co. v. Ply Gem Indus., Inc.*, 343 N.J. Super. 430, 454, 778 A.2d 1132, 1146 (App. Div. 2001) (rejecting applicability of continuous trigger to construction defect claim where evidence did not demonstrate damage upon installation followed by a continuous process of deterioration).

Although decided in the context of a "continuous property damage" claim, there is no reason to think that the decision does not apply to other claims in which an insurer seeks to recover defense costs from a co-insurer. Insurers should operate under the assumption that an independent settlement with an insured will not insulate it from liability to a co-insurer under that co-insurer's independent claim for contribution.

Also unanswered is an insured's liability for defense costs where it lacked insurance for one or more years during the period of damage. In Potomac the insured was continuously insured during the period of the

damage, and thus the question of how allocation of defense costs will work for uninsured periods was not before the Court. However, the Court wrote that one of the reasons for allowing allocation of defense costs under the *Owens-Illinois* method is that it creates an additional incentive for individuals and businesses to purchase sufficient coverage every year. This strongly suggests that the insured will be bear the burden of defense costs allocated to any year for which there is a gap in insurance.

For more information please contact Kenneth Portner at kportner@wglaw.com or 215.972.7921.