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### NOW YOU SEE IT (NOW YOU DON'T?) – RECENT INSURER EFFORTS TO VOID COVERAGE BASED ON NEW YORK RESCISSION LAW

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In recent months, insurers have increasingly used New York rescission law as a means to not only deny coverage for specific claims, but also to void any protection an insurance policy may provide for other losses down the road. For example, interpreting New York law, the U.S. Court of Appeals for the Third Circuit recently allowed an insurer to rescind its policy after the insured failed to disclose two losses totaling over \$5 million on its application for recall insurance.[1] In early June, the U.S. Court of Appeals for the Second Circuit allowed another insurance company to rescind its policy issued to an accounting firm after the executive who filled out the policy application neglected to mention an ongoing \$2 million securities fraud scheme involving his clients.[2] And soon, the U.S. District Court for the Southern District of New York will decide whether an insurer can void a \$10 million recall policy based on a frozen food company's alleged failure to disclose code violations in its processing plants.[3] These cases – and others – present a new source of concern, particularly related to policies that contain New York choice-of-law provisions.

#### Rescission

Rescission voids a policy from its inception, making the coverage completely unavailable for any pending and future claims.[4] Under New York law, an insurer may be able to rescind its contract if the insured made a material misrepresentation or failed to disclose certain material information, and the insurer would not have issued the policy had it known about the misrepresentation or failure to disclose.[5] Using underwriting records, company practices, and other means, the insurer may only have to show that it would not have issued the specific policy at hand, and not that it would not have issued any policy to the insured. After an insurer discovers a misrepresentation or non-disclosure, the law allows for a "reasonable investigation period" before the insurance company must bring an action seeking rescission.[6]

#### How Policyholders Can Minimize Risks Associated with Rescission Claims

Here are some tips policyholders should keep in mind to avoid or minimize risks associated with rescission claims:

##### *Your Policy Applications*

Intent to harm or mislead may matter in many areas of the law, but not so much for most rescission claims. For example, in one New York case, after a jeweler's store was burglarized, its insurer sought to rescind the policy based on material misrepresentations made in the application.[7] The court denied the insured jeweler's motion for a new trial, writing that while "the misrepresentations were not made with intent to deceive," an insurer "need not show fraud to avoid the policy." [8] Keep that in mind when you review your policy applications before submitting them to your carriers. Even negligently failing to provide the necessary information can be fatal, even when there is no intent to deceive.

##### *Your Insurer's Knowledge of Particular Risks*

Specific disclosures are more effective than providing notice generally in other contexts. For example, when faced with a rescission action for omitting past recalls on its policy application, H.J. Heinz Company argued that its insurer knew about the recalls long before the rescission claim.[9] Heinz claimed that it had disclosed one prior loss in a previous application for a different kind of insurance and pointed to internal emails indicating that one of the insurer's employees had read an article about another of Heinz's prior losses.[10] Be aware that in this case, the Third Circuit upheld the district court's conclusion that "these items, without more, would not trigger a reasonably prudent insurer to follow-up further" and judgment rescinding the policy.[11]

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## Your Insurer's Actions After You Submit Your Claim

Insurers need to either rescind coverage or treat the policy as valid—but they cannot have it both ways. For instance, “[w] here an insurer accepts premiums after learning of an event allowing for cancellation of the policy, the insurer has waived the right to cancel or rescind.”[12] In a 2009 decision, the court found that an insurer waived its right to rescind by waiting approximately 10 months after learning of a potentially material misrepresentation by its insured before asserting its right to void its policies.[13] The court held that this delay was “unreasonable as a matter of law,” quipping that “only Rip Van Winkle slept longer.”[14] After you submit your claim, pay attention to what your carrier does and when.

## Your Actions After You Submit Your Claim

We all know that in the context of criminal law, if you are arrested, anything you say can and will be used against you, thanks to the Miranda warning (and *Law & Order*). That familiar adage applies to rescission as well. In a recent decision, an insured’s testimony that his house was structurally configured as a three-family dwelling contradicted his policy application, which stated that it was a two-family dwelling, as well as his other statements that he believed his house was a legal two-family dwelling.[15] The court held that this amounted to a material representation, justifying the insurer’s rescission of the policy.[16] Be careful regarding the statements you make in your correspondence with your carrier—they may be used against you later.

## Conclusion

As the examples above demonstrate, rescission can be extremely expensive. In the Heinz decision, for instance, Heinz found itself without coverage for a \$30 million recall after its insurer rescinded its policy and incurred significant attorneys’ fees litigating in multiple courts. Companies must be aware of the dangerous exposure—and high price tag—that can accompany misstatements or non-disclosures, even unintentional ones, when procuring coverage, and the tips above should help mitigate the risks.

## Endnotes

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[1] *H.J. Heinz Co. v. Starr Surplus Lines Ins. Co.*, 675 F. App’x 122, 126, 130 (3d Cir. 2017) (applying New York law).

[2] *Continental Cas. Co. v. Marshall Granger & Co.*, 6 F. Supp. 3d 380, 390-92 (S.D.N.Y. 2014), *aff’d*, *Continental Cas. Co. v. Boughton*, No. 16-2384, 2017 WL 2416902, at \*4 (2d Cir. June 5, 2017).

[3] *Starr Surplus Lines Ins. Co. v. CFR Frozen Foods, LLC*, No. 1:17-cv-01030 (S.D.N.Y. originally filed Feb. 10, 2017).

[4] This may not be true for rescission actions involving workers compensation. See *NorGuard Ins. Co. v. Lopez*, No. CV 15-5032, 2017 WL 354209 (E.D.N.Y. 2017) (finding the insurer cannot void a contract ab initio to get around law governing insurance for workman’s compensation under WCL § 54(5)).

[5] See N.Y. Ins. Law § 3105(b)(1) (McKinney 2011) (“No misrepresentation shall avoid any contract of insurance or defeat recovery thereunder unless such misrepresentation was material. No misrepresentation shall be deemed material unless knowledge by the insurer of the facts misrepresented would have led to a refusal by the insurer to make such contract.”).

[6] *Continental*, 6 F. Supp. 3d at 394.

[7] *Essex Ref. Corp. v. Home Ins. Co.*, 394 N.Y.S.2d 507, 508 (N.Y. Sup. Ct. 1975).

[8] See *id.*

[9] See *Heinz*, 675 F. App’x at 129-30.

[10] See *id.*

[11] See *id.* at 126, 130.

[12] *Continental Ins. Co. v. Helmsley Enters., Inc.*, 622 N.Y.S.2d 20 (N.Y. App. Div. 1995).

[13] See *GuideOne Specialty Mut. Ins. Co. v. Congregation Adas Yereim*, 593 F. Supp. 2d 471, 484 (E.D.N.Y. 2009).

[14] See *id.*

[15] See *Estate of Gen Yee Chu v. Otsego Mut. Fire Ins. Co.*, 49 N.Y.S.3d 468, 469-70 (N.Y. App. Div. 2017).

[16] See *id.*

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