NEW YORK RESCISSION LAW STRIKES AGAIN: LESSONS LEARNED FROM THE VOIDING OF HEINZ'S PRODUCT CONTAMINATION INSURANCE POLICY

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Insurance Coverage Alert

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An increasingly popular tool in the insurer's toolset is attempted rescission of the policy. This tool is particularly sharp if the law applicable to the construction of the policy is that of New York. Earlier this week, the United States District Court for the Western District of Pennsylvania issued a ruling that serves to remind policyholders just how powerful a weapon rescission can be when certain circumstances align. Putting aside for present purposes the correctness of the Court's factual findings and legal rulings, there are several ways in which policyholders can help shield themselves from the blow.

In May 2015, H.J. Heinz Co. ("Heinz") sued Starr Surplus Lines Insurance Company ("Starr") for breach of contract, declaratory judgment and bad faith arising from Starr's denial of Heinz's claim for coverage under a product contamination policy for losses incurred when its baby cereal product was recalled.[1] Starr counterclaimed and, among other defenses, sought rescission of the policy, claiming that Heinz knowingly and in bad faith omitted from its insurance application, and thereafter concealed from Starr, material facts relating to its loss history that would have led Starr not to issue the policy or to require different policy terms, including a greater premium for the risk it accepted and/or a larger self-insured retention.[2] On December 14-16, 2015, the Court conducted an advisory jury trial on the sole issue of Starr's equitable counterclaim for rescission.[3] The jury determined that Starr proved by a preponderance of the evidence that Heinz made material misrepresentations in its insurance application, but also that Heinz proved by a preponderance of the evidence that Starr waived the right to assert a rescission claim by agreeing to sell the policy despite sufficient knowledge of the misrepresentations or by failing to promptly assert rescission after it became aware of the grounds for it.[4]

Although the Court agreed with the jury's determination that Heinz had made material misrepresentations on its insurance application, the Court departed from the jury's determination regarding the waiver issue and found instead that Heinz had "fallen short on carrying its burden of proof on the affirmative defense of waiver."[5] As to Heinz's alleged misrepresentations, the Court found that Heinz intentionally failed to disclose, *inter alia*, a January 2014 incident in which, according to the Court's opinion, Chinese government food safety agents detected that Heinz baby cereal products were contaminated with levels of nitrate that exceeded the limit imposed by Chinese law, leading Heinz to conduct a "silent recall" in which it destroyed 245,000 pounds of product and suffered losses between $11-12 million.[6] According to the Opinion, Heinz offered evidence that the basis for its not reporting this incident on the application was its assessment that this loss would not have been covered by the type of policy it was applying for – a contaminated products insurance policy.[7] The Court rejected Heinz's proffered

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justification, noting that the insurance application expressly sought the disclosure of all withdrawals, recalls and stock recoveries "whether or not insured or insurable" under an accidental and malicious contamination policy.[8]

In departing from the advisory jury's determination that Starr had waived its right to rescind the policy, the Court, applying New York law, noted that Starr may not have been "perfect" in its underwriting of Heinz's policy, but "perfection is not the standard."[9] According to the Opinion, Heinz offered evidence and had argued, among other things, that "Starr had, or should have obtained sufficient knowledge of the misrepresented information from other previous insurance application(s)," as well as from disclosures in its 10-K and publicly available information in newspaper articles recounting Heinz's losses.[10] The Court found, however, that, notwithstanding this evidence, Starr "did not have sufficient 'knowledge'" to support a waiver of a rescission remedy simply "because of certain information in a prior application for a different type of insurance policy, or because a newspaper article discussing the undisclosed incidents was contained in Starr's underwriting files."[11] According to the Court, "[t]hese items, without more, would not trigger a reasonably prudent insurer to follow-up further."[12] Putting aside the correctness of the Court's departure from the advisory jury's determination, the Court's ruling offers significant lessons.

For policyholders, the *Heinz* decision should serve as a cautionary tale. Insurers too often include misrepresentation in the insurance application as one of dozens of standard defenses to claims for coverage, sometimes regardless whether there is any legitimate basis for the defense. But when the evidence supports a finding that material misrepresentations were made, courts will consider seriously whether the circumstances justify the "extraordinary equitable remedy" of rescission.[13] There are, however, steps that policyholders can take to reduce the likelihood of their falling prey to this extraordinary relief.

First, choice of law may matter. Insurance policies vary widely as to whether they contain a choice of law provision. When a choice of substantive law appears in an insurance policy, it is often that of New York. If open to negotiation, policyholders should consider carefully whether, on balance, New York is a favorable governing law. In *Heinz*, the policy contained a choice of law provision but choice of law was nevertheless hotly disputed,[14] and for good reason. Although New York may be a favorable jurisdiction for policyholders on certain issues, it is well recognized as unfavorable for policyholders on the issue of rescission. The *Heinz* decision is just the latest in a line of anti-policyholder decisions, based on New York law, on the issue of policy rescission.[15] According to the Court, Heinz's "intentional ***and unintentional*** misrepresentations" were both actionable under New York law, while under Pennsylvania law, for example, a policyholder must have made a false representation knowingly or in bad faith in order for the policy to be voided.[16]

Second, policyholders need to take appropriate care during the application process when answering questions regarding loss and claims history. Heinz paid dearly for not disclosing a previous product recall because, in the Court's view, Heinz supplanted its own judgment for that of the underwriters regarding what would be considered material to the underwriters' assessment of the risk.

Third, policyholders should remember that when an insurance claim arises, it may be negatively affected by perceived deficiencies in policy application submissions, notwithstanding the broker's assistance in assembling the information. The *Heinz* Court rejected Heinz's argument that it should not have the policy rescinded because it relied upon its insurance broker to complete the missing parts of the insurance application.[17] Having itself certified that the statements set forth in the application were true and that no material information was withheld, Heinz was on the hook for whatever representations were made therein.[18]

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Although the *Heinz* decision may appear troubling for policyholders, rescission of an insurance policy remains an extreme remedy that most courts quite properly are reluctant to impose. Even with respect to the *Heinz* decision, it is worth noting, if not underscoring, that the advisory jury reached a determination contrary to that of the Court on the question of waiver. These types of decisions are governing law and fact dependent, and the results are not a foregone conclusion. Nonetheless, insurers can be expected to pursue the remedy, especially when New York law governs policy interpretation.

Notes:

[1] *See* Complaint at 5-11, *H.J. Heinz Co. v. Starr Surplus Lines Insurance Co.*, No. 15-CV-00631 (W.D. Pa. 2016) ("*Heinz*")

[2] *See* Counterclaim at 11, 16-18, *Heinz Co. v. Starr Surplus Lines Insurance Co.*, No. 15-CV-00631 (W.D. Pa. 2016).

[3] Memorandum Opinion Setting Forth Findings of Fact and Conclusions of Law on "Phase One" – Counterclaim for Rescission, *H.J. Heinz Co. v. Starr Surplus Lines Ins. Co.*, No. 15-CV-00631 (W.D. Pa. 2016) (the "Opinion").

[4] *Id.* at 2-3.

[5] *Id.* at 27.

[6] *Id.* at 6.

[7] *Id.*

[8] *Id.* at 5 n.5, 6.

[9] *Id.* at 12.

[10] *Id.* at 20.

[11] *Id.* at 12.

[12] *Id.*

[13] *Id.* at 26.

[14] *See id.* at 9 n.12. Even though Starr's policy contained a choice of law provision that stated that the "construction, validity and performance" of the policy was to be governed by New York law, Heinz had argued that the policy's service of suit provision called for application of Pennsylvania law. *See* Order Re: Substantive Choice of Law Provisions at 2-3, *H.J. Heinz Co. v. Starr Surplus Lines Ins. Co.*, No. 15-CV-00631 (W.D. Pa. 2016). The Court ruled in Starr's favor, holding that New York law applied. *Id.* at 7.

[15] *See, e.g.*, *128 Hester LLC v. New York Marine & Gen. Ins. Co.*, 5 N.Y.S.3d 69, 70 (N.Y. App. Div. 2015) (granting rescission where the policyholder allegedly made material misrepresentations on its application for property insurance and noting "[e]ven innocent misrepresentations are sufficient to allow an insurer to avoid the contract of insurance or defeat recovery thereunder") (internal quotation omitted); *Kiss Const. NY, Inc. v. Rutgers Cas. Ins. Co.*, 877 N.Y.S.2d 253, 256 (N.Y. App. Div. 2009) (granting rescission of a commercial general liability policy on summary judgment).

[16] *See* Opinion at 9 n.12.

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[17] *See id.* at 8.

[18] *Id.* at 19. Additionally, according to the Court, under New York law, "[a] misrepresentation made by a broker is imputed to an insured." *Id.* at 8 n.11 (citing *Bloom v. Mutual of Omaha Ins. Co.*, 161 A.D.2d 1047, 1049 (N.Y. App. Div. 3d Dept. 1990)).

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