

Insurance Coverage Wargames: Avoiding the Landmine of Policy Rescission

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Claim disputes with insurers often turn on events occurring long before the loss itself. Insurers frequently deny coverage where they suspect that an insured may have had prior knowledge of events giving rise to a claim. Claims are also refused when an insurer believes that a claim is **related** to an earlier claim. However, as illustrated by a recent decision in the U.S. District Court for the District of New Jersey, insurers also sometimes take the nuclear approach to avoiding coverage: suing for policy rescission. Rescission is a drastic equitable remedy that, in essence, asks a court to find that the policy be deemed void – as if it never existed.

In *Harford Mutual Insurance v. Z&D Realty*, an insured obtained general liability insurance for several of its related businesses located on an interconnected property. The insured owned a restaurant and banquet hall that were connected by interior doorways and shared the use of a liquor license. However, when the insured was faced with a lawsuit arising out of a shooting at the banquet hall, its insurers denied coverage and filed a preemptive lawsuit against the insured seeking, among other things, rescission of their policies. The court held that the insurers were entitled to rescind the policies, finding that the insured had omitted material information in its applications by failing to identify the banquet hall as a separate limited-liability business entity and by incorrectly answering questions as to whether there would be social events on the premises.¹

The *Z&D Realty* opinion reinforces the importance of carefully addressing each question in an insurance application. In many jurisdictions, an insurer “need not show that the insured actually intended to deceive,” and “[e]ven an innocent misrepresentation” in an insurance application can result in the rescission of the policy. While an insured is not typically required to volunteer information that an application does not ask for, unintentional or mistaken inaccuracies in responses have the

potential to result in a total loss of coverage. The standard applied by the District Court for the District of New Jersey was simply whether the application contained “false statements [that] materially affect[ed] the acceptance of the insurable risk or the hazard assumed by the insurer.” The court was not swayed by the fact that the insurers would have discovered the functional – and physical – connection between the restaurant and banquet hall through minimal diligence efforts, such as a physical inspection of the premises.

The consequences of policy rescission can be dire, leaving a business entirely uninsured for all risks covered by that policy. This impacts not only pending claims, but also any other claims that would have been covered under the policy. A rescinded insurance policy is “treated as if it does not exist for any purpose.” Businesses should therefore adhere to two best practices when applying for insurance:

I. Route Specialized Questions to Qualified Professionals

Insurance applications often seek specialized information that is best answered with the assistance of in-house counsel or other professionals. Questions seeking financial information should be reviewed by accounting professionals. Technical questions relating to an applying company’s information technology systems and infrastructure should be answered by IT professionals. Approximations and guesswork in answering insurance application questions should be avoided at all costs to ensure that an innocent mistake does not lead to an unexpected, unwelcome, and potentially ruinous result.

II. Utilize Experienced Brokerage Firms and Coverage Counsel

Businesses should also maintain a relationship with sophisticated and experienced insurance brokers, who can provide guidance not only in completing

¹ *Harford Mut. Ins. Co. v. Z&D Realty, LLC*, 2022 WL 18024201, at *7 (D.N.J. Dec. 29, 2022).

the application process, but also in assessing the coverage needs of that business. An experienced broker will seek to understand a business and recommend coverage that is tailored to its specific risks. Additionally, brokers are better positioned to secure optimal coverage for a business when they are **working hand-in-hand with experienced coverage counsel**, who can negotiate the best possible policy terms on behalf of the insured without straining the broker's relationship with insurance company representatives. These professionals can also assist in navigating thorny issues presented by insurance applications and challenging fact patterns.

While completing an insurance application is often viewed as a routine business task, *Z&D Realty* serves as a timely reminder that even innocent inaccuracies can have unexpected and unwelcomed consequences. By taking extra care in responding to application questions, businesses can be spared the draconian result of policy rescission. As Benjamin Franklin once said: "an ounce of prevention is worth a pound of cure."

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