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Heinz Ruling Boosts Insurers That Skip The 'Scavenger Hunt'

By **Jeff Sistrunk**

Law360, Los Angeles (February 1, 2016, 10:26 PM ET) -- A Pennsylvania federal judge's decision Monday to disregard a jury verdict and allow Starr Surplus Lines Insurance to void a Heinz product contamination policy adds to a long line of policyholder losses on rescission claims under New York law, giving ammunition to insurers that argue they don't have to investigate what isn't on a policy application.

Ruling in a dispute over $25 million in coverage for lead-tainted baby food, U.S. District Judge Arthur J. Schwab agreed with an advisory jury's determination in December that Heinz had made material misrepresentations on the policy application, but he disagreed with the jury's conclusion that New York-based Starr lost its ability to rescind the policy because it knew about the misrepresentations and sold the policy anyway.

While New York has become a more policyholder-friendly jurisdiction in recent years, it remains difficult for policyholders to prevail on a rescission claim under the state's law, and Judge Schwab's decision to rescind H.J. Heinz Co.'s policy in the face of a contrary jury verdict is a glowing example of the trend, according to attorneys. Under New York law, an insurance company only has to prove that a policyholder made a deceptive misrepresentation or omission on a policy application, whether it was intentional or accidental, to rescind a policy.

"New York has long been a haven for New York insurers. That's why many insurers have included New York choice-of-law provisions in specialty policies," said Michael S. Savett, counsel at Hill Wallack LLP. "The state has become less insurer-friendly in recent years, particularly involving issues such as late notice of claims and lawsuits. As to rescission, though, this case bears out that New York's longstanding reputation still holds true."

Perhaps the most intriguing nugget of Judge Schwab's ruling for insurers was his rejection of Heinz's contention that Starr should have been aware of its misrepresentations at the time the policy was issued based on information outside of its policy application, such as data in a prior application for a different insurance policy and a newspaper article about past woes involving its products, according to attorneys.

Judge Schwab wrote that those outside materials, "without more, would not trigger a reasonably prudent insurer to follow up further."

Starr's underwriters shouldn't have been expected to determine "whether, at some point in history, Heinz disclosed something about one of the listed losses that might have prompted further inquiry, in order to properly assess the risk," the judge said.

Hangley Aronchick Segal Pudlin & Schiller Vice Chairman Ronald P. Schiller said Heinz's argument is a common one for publicly traded companies, which can claim that insurers should have done their own search of public documents, news clippings and other sources.

"The judge here rejected that argument," Schiller said. "That's important for future rescission cases, saying an insurer is not required to go on a scavenger hunt to ferret out information."

According to Judge Schwab's decision, Starr proved that Heinz made material misrepresentations on its policy application by failing to mention a number of prior incidents in response to questions inquiring whether the food company had been the subject of a government agency complaint within the preceding three years or had experienced any product recalls or withdrawals within the preceding 10 years.

Evidence shows, among other things, that Heinz failed to disclose Chinese food safety agents' determination in 2014 that its baby cereal products were contaminated with nitrite, which led the company to destroy 245,000 pounds of the product, or the company's recall in 2013 of mercury-tainted baby food and a corresponding fine by the Chinese government, according to the judge's findings.

Judge Schwab concluded that Heinz made the misrepresentations for the purpose of either obtaining a lower self-insured retention or lower policy premium. The judge found testimony by Heinz's global insurance director, including that he was relatively new at his job and that he didn't think the omitted information or false answers would be "material," to not be credible.

In disagreeing with the advisory jury's determination that Starr waived its right to rescind the policy, the judge held that there was insufficient evidence that the insurer had knowledge of Heinz's misrepresentations when it issued the policy. Heinz had argued that Starr had sufficient knowledge because of information in prior applications for a different type of policy and a newspaper article discussing the undisclosed incidents that was contained in the underwriting file.

Judge Schwab, however, said that Starr's underwriters had acted "professionally and prudently" and shouldn't have been expected to look over the application for a different type of insurance or independently verify the entries on Heinz's loss history.

While it was slightly unusual for Judge Schwab to deviate from the jury's verdict to render a decision in favor of Starr, it was ultimately unsurprising, given New York's lower burden of proof for insurers on rescission claims, according to attorneys.

New York law is "fairly draconian" with respect to rescission, as the state applies the "marine rule" stating that even an innocent misrepresentation is sufficient for an insurer to rescind a policy, said Barry Zalma, an insurance coverage and claims handling lawyer who serves as a consultant and expert witness specializing in insurance issues.

"A misrepresentation doesn't have to be intentional to allow rescission," Zalma said.

However, Judge Schwab pointed out in a footnote that he would have ruled against Heinz even if a higher standard for rescission had been applied. That means that the judge's ruling may be cited in rescission cases governed by other states' law, according to attorneys.

"Although this case was decided under New York law, the judge takes pains to say that even if it was decided under the law of a jurisdiction requiring fraud or intentional misrepresentation, Heinz's conduct meets that definition too," Schiller said. "That means this case will be cited more generally."

Heinz faces a tall task if it appeals Judge Schwab's decision, given the judge's determination that the company made multiple misrepresentations for the purpose of securing a lower self-insured retention or premium on the policy and his conclusion that Heinz's witnesses were not credible while Starr's witnesses were believable, experts say.

"It would be one thing if there was one minor omission, but Heinz failed to disclose quite a bit," Nossaman LLP partner Joan Cotkin said.

"A judge's perception of a witness's credibility is a difficult thing for a reviewing court to overturn," Cotkin continued. "If this judge missed some piece of evidence, or misdescribed evidence, Heinz may be able to make an argument on those grounds."

At bottom, Judge Schwab's decision is a cautionary tale for policyholders to be careful and ensure

that they disclose every piece of relevant information in a policy application, attorneys say.

"The overall message here is that policyholders really need to be upfront with insurance companies and disclose the good, the bad and the ugly in terms of their claim history and loss history in order for insurers to more accurately assess premium and risk," Savett said.

Indeed, requiring diligence on the part of the policyholder at the outset is in both parties' best interest and can prevent future coverage disputes, according to attorneys.

"Requiring full disclosure at the inception of the insurance contract and granting a statutory right to rescind based on concealment or material misrepresentation at that time safeguard the parties' freedom to contract," Zalma said.

Heinz is represented by Jared Zola and James Murray of Dickstein Shapiro LLP, Kevin P. Allen of Eckert Seamans Cherin & Mellott LLC and in-house by Sabrina J. Hudson.

Starr Surplus is represented by Robert Frank, John Nadas and Matthew B. Arnould of Choate Hall & Stewart LLP and Robert J. Marino and J. David Ziegler of Dickie McCamey & Chilcote PC.

The case is H.J. Heinz Co. v. Starr Surplus Lines Insurance Co., case number 2:15-cv-00631, in the U.S. District Court for the Western District of Pennsylvania.

--Editing by Jeremy Barker and Christine Chun.