INSURANCE LAW

RETROACTIVE CANCELLATION AND/OR REFORMATION OF AUTO POLICIES

By: Jonathan A. Dachs, Esq.

One of the most well-established propositions of New York Insurance Law (not at all a universal view) is that there is no right to cancel a policy of automobile liability insurance retroactively ("ab initio") as against an innocent third party, even for fraud or misrepresentation in the procurement of the policy. Such cancellations are, however, allowable against the participants in the fraud.[1]

O'Connor

Almost sixty years ago in *Aetna Cas. & Sur. Co. v. O'Connor*, 8 AD2d 530 (2d Dept. 1959), aff'd. 8 NY2d 359 (1960), the New York Court of Appeals was presented with the following question (of first impression): "Does the New York Automobile Assigned Risk Plan of Insurance, which in explicit terms provides only for prospective cancellation, abrogate the insurer's common law right to void a policy from its inception on the ground that it had been obtained through fraud or misrepresentation?"

The undisputed facts in that case established that in his application for insurance under the Assigned Risk Plan ('the Plan"), O'Connor falsely stated that he had not been convicted of any non-vehicular offense within the preceding three-year period, when, in fact, he had actually been convicted twice for disorderly conduct and twice for public intoxication -- a fact that rendered him ineligible for insurance under the Plan's rules. The Plan assigned the risk to Aetna, which, relying upon the misrepresentations, issued a policy for a one-year period. Aetna promptly conducted an investigation, which failed to uncover the prior convictions. Nine months later, while the policy was still in force,

O'Connor's vehicle was involved in an accident that caused property damage and personal injuries. Receipt of a report of the accident initiated another investigation, which resulted in Aetna's discovery of the insured's four prior convictions. Aetna then informed the injured parties that it would decline coverage on the policy, and notified the insured that it elected to rescind his policy, and to void it from its inception. The Supreme Court and Appellate Division both decided the Declaratory Judgment action commenced by Aetna in favor of O'Connor, holding that although Aetna had a right to cancel under the Plan, it did not have the right to rescind (or void) it from its inception.

The Court of Appeals viewed the question before it as turning on the construction to be accorded to the Assigned Risk Plan. Based upon a detailed review of the history and specific provisions of the Plan, the Court concluded that it "reflects a design to supply an extensive and comprehensive scheme of regulation of the contractual relationship concerned," and, therefore, the carrier may not void the policy from its inception since that remedy is not provided by the Plan. The Court also found that "a number of the individual provisions of the Plan imply an intention to limit the insurer, if fraud and misrepresentation be charged, to the right to cancel on 10 days' notice as specified in section 18, an intention, in other words, to abrogate the common-law right to rescind on the ground of fraud or misrepresentation." 8 NY2d at 363.

Finally, the Court explained, as follows:

> "That there is no right to rescind the assigned risk policy does not mean that the carrier is deprived of all reasonable redress against the insured who misrepresents material facts in order to obtain coverage, since the Plan expressly provides for cancellation under these circumstances. The effect of the Plan is to enforce upon the insurer the necessity to discover fraud at the earliest possible moment, before an accident occurs and

> the rights of innocent injured third parties have intervened. In this respect, the Plan merely reflects the oft-repeated legislative recognition that liability insurance is not the concern solely of the insured and his insurer. (See, e.g., Insurance Law, §345, subd. [l], par [1]; *Lauritano v. American Fid. Fire Ins. Co.*, 3 AD2d 564, 567-568, aff'd. 4 NY2d 1028).
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> "Aetna did, in this case, actually conduct an early investigation of O'Connor and, if that investigation had been performed properly, the insured's misrepresentation would have been discovered and Aetna could have canceled, pursuant to section 18 of the Plan, long before the [claimants] were injured. While, therefore, Aetna may ultimately be held on a policy obtained by fraud, its liability is in a very real sense attributable to its own fault, and the true beneficiary is not the wrongdoer, but his innocent victims." Id. at 364-365.

Teeter

In *Teeter v. Allstate Ins. Co.*, 9 AD2d 176 (4th Dept. 1959), aff'd. 9 NY2d 655 (1961), the courts examined the issue of retroactive cancellation of an auto insurance policy in the context of the termination provisions contained in the Motor Vehicle Financial Security Act (also known as the "compulsory insurance law," formerly Vehicle & Traffic L. §§93-93-k, now §§310-321).

On August 15, 1957, Allstate issued a binder to Mr. Teeter for a liability insurance policy covering his automobile. In procuring that binder, Teeter concededly falsely represented to the insurer that he had not had any accident within the preceding two years, and that no insurance policy issued to him had ever been canceled.

After the binder and a certificate of insurance were issued by Allstate's agent, Teeter's application was referred for processing to Allstate's regional office, where its employees quickly discovered the falsity of Teeter's representations. Thus, on August 23, 1957, Allstate wrote a letter to Teeter, notifying him that "the insurance extended under the

binder" was thereby "canceled and declared void from its inception," and enclosing a check in the amount of a full refund of the paid premium.

The governing statute at the time, Vehicle and Traffic Law §93-C (now §313), provided, as pertinent hereto, that "No contract of insurance or renewal thereof for which a certificate of insurance has been filed with the commissioner shall be terminated by cancellation or failure to review by the insurer until at least ten days after mailing to the named insured at the address shown on the policy a notice of termination."[2] There was no dispute that the August 23, 1957 letter purporting to cancel the binder "from its inception" did not comply with the statutory provision because it did not give Teeter a notice of termination to take effect 10 days thereafter.

In a Declaratory Judgment action commenced by Teeter seeking a declaration, *inter alia*, that Allstate's termination was not effective as of August 15, 1957, Fourth Department observed that the question presented to it (a matter of first impression at the time) was "whether the common-law right of rescission *ab initio* for fraud survived the adoption of the statute, or whether the statutory method of terminating coverage on notice, prescribed in [the statute], is the sole and exclusive method by which insurance coverage, for which a certificate of insurance has been issued [in accordance with the statute], can be terminated"? The court concluded that "the latter alternative is the correct one." 9 AD2d at 180.

In explaining its conclusion, the Appellate Division observed, as follows:

> "The provision of the section for a 10-day notice of termination makes it impossible to have *ab initio* rescission. While the provision does not take away the right to rescind for fraud, it restricts its operative effect. The rescission cannot be made effective retroactively as it could be at common law; it can be

made effective only prospectively, as of a date not less than 10 days after the service of the prescribed notice."

"It is impossible to reconcile the existence of a right to rescind *ab initio* with the general scheme of the compulsory insurance law. The purpose of the statute is to assure, so far as possible, that there will be no certificate of registration outstanding without concurrent and continuous liability insurance coverage. . . .

"But it would be obviously impossible for an insured to comply with his statutory obligation [to obtain insurance for his or her vehicle] if a common-law right to rescind *ab initio* were allowed to exist alongside the statutory provision for termination by notice. If a rescission were allowed to be effective retroactively as of the date of the issuance of the policy, it would be impossible for the insured to do what the statute requires him to do, *i.e.*, either procure new insurance or surrender his number plates, prior to the date upon which the termination of the coverage became effective. Furthermore, he would be retroactively rendered guilty of a misdemeanor for having operated from the date of the issuance of the policy to the date of the rescission, even though his conduct was lawful at the time that he engaged in it. Such a result could not have been intended by the Legislature.

"Once a certificate of insurance under [the statute] has been issued by the insurance company and filed with the Commissioner, the contract of insurance ceases to be a private contract between the parties. A supervening public interest then attaches and restricts the rights of the parties in accordance with the statutory provisions. Many common-law contractual rights are restricted by the statute. . . . The common-law right to rescind *ab initio* for fraud must . . . yield to superior force of the statute. Whether the action taken by the insurance company upon the discovery of the fraud is called a rescission or a cancellation, it cannot be effective to terminate the policy until a date specified in the notice not less than 10 days after its mailing . . . .

"If the insurer wishes to avoid or minimize the risk of being held liable on a policy obtained by fraud, for a period running from the date of its issuance to a date 10 days after mailing of notice of termination, it must make its investigation of the applicant's record and truthfulness of his representations prior

> to issuing a binder or an insurance policy and the accompanying certificate of insurance. Once an insurer issues a binder or insurance policy and gives the insured a certificate of insurance for filing with the Bureau of Motor Vehicles, it is barred from asserting that the insurance coverage failed to attach on the date of issuance or that it failed to continue in force thereafter, during the period during which the certificate of insurance remained uncancelled. A certificate of insurance constitutes a representation by the insurance company to the public and to the State authorities that valid insurance coverage is in effect. The whole scheme of the statute would be frustrated if the insurance company were allowed, because of a hidden infirmity in the policy, to nullify it retroactively with respect to a period during which the company had led the public and the authorities to believe that insurance coverage was in effect [citations omitted]."

The Court of Appeals unanimously affirmed the Appellate Division decision (without opinion).

Numerous cases since *Teeter* have similarly held that Vehicle and Traffic Law §313(1)(a) supplants an insurer's common-law right to cancel an auto policy retroactively on the grounds of fraud or misrepresentation, and mandates that the cancellation of a policy pursuant to its provisions may only be effected prospectively. This provision places the burden on the insurer to discover any fraud before issuing the policy, or as soon as possible thereafter, and protects innocent third parties who may be injured due to the insured's negligence.[3]

Reformation Cases – *Olivio*

In *Olivio v. Government Employees Ins. Co. of Washington, D.C.*, 46 AD2d 437 (2d Dept. 1975), the plaintiffs were passengers in a motor vehicle owned and operated by GEICO's insured, Cadogan. The vehicle was insured with limits of $20,000/$40,000 under a liability policy issued to Cadogan based upon an application in which she represented

that: (1) she held a valid unrestricted operator's license or permit; (2) she had not had any automobile driver's license, permit or privilege suspended, revoked, or refused; and (3) neither she nor any member of her family had been convicted of or forfeited bail, or paid any fines, for driving violations or citations, other than parking, in the three years preceding the date of the application. During the period that the policy was in effect, the insured vehicle was involved in a head-on crash with another vehicle, which resulted in personal injuries to the plaintiffs and the other driver.

Three months later, GEICO ascertained that Cadogan had lied in her application when she gave the three responses noted above. Three-four weeks thereafter, GEICO informed its insured, Cadogan, and counsel for the plaintiffs, that it would undertake defense of the plaintiff's personal injury suit "since the laws of the State of New York prohibit recission [sic] of your policy from the date of inception," but that it would indemnify her "for resulting loss to the extent of $10,000 for each person with a maximum of $20,000 [the then-applicable minimum statutory bodily injury liability coverage limits]" [emphasis added], and delete medical payments, extraterritorial uninsured motorist, and collision coverage from the policy. The plaintiffs thereafter commenced a Declaratory Judgment action and simultaneously moved for judgment declaring that GEICO was obligated to pay up to $20,000/$40,000 under its policy on account of any judgments recovered by the plaintiffs against them.

In opposition to the plaintiffs' motion, GEICO admitted its issuance of its policy with $20,000/40,000 coverage to Cadogan prior to the accident, but claimed that it did so in reliance on her misrepresentations, and that it had, therefore, disclaimed coverage beyond the minimum of $10,000/20,000 required by the statute. GEICO further stated that it had

brought its own action for reformation and rescission of the policy, viz., thus to reduce the amounts of the coverage and to eliminate certain coverages entirely, i.e., medical payments, *etc.* GEICO also said that it had interposed an answer on behalf of Cadogan in the negligence action.

In analyzing the issue presented to it, the Second Department first observed that "It is now settled law in this State that since section 313 abrogated the previously existing common-law right of rescission *ab initio*, such a right of termination operates prospectively only" [citing *Teeter*, supra]. The court then noted that *Teeter* and its progeny, did *not* dispose of the issue presented in this case "since we are faced with an appeal which seeks a determination of whether an insurer may legally seek to reform, not rescind, its policy where the policy was obtained through fraud [emphasis added]."

Daly

The *Olivio* court noted that "in *Reliance Ins. Cos. v. Daly* (67 Misc.2d 23 [Sup. Ct. Nassau Co. 1971], mod. in other respects 38 AD2d 715 [2d Dept. 1972]), the court, in another context, was faced with the specific problem here raised." There, Reliance, which issued a policy with bodily injury coverage of $300,000/500,000, discovered, approximately three months after the issuance of the policy, and one month after its insured was involved in an accident in which a passenger sustained injuries causing his death, that the insured had falsely stated in his application for the policy that he had no traffic violations for the 39-month period prior to the effective date of the policy, when in fact he had four such violations. Reliance's search of the insured's driving record about the time he made application for the policy did not uncover this fact. Reliance, after defending and settling

the action against its insured for the sum of $175,000, sought by a declaratory judgment action, to reform the policy to bring its coverage down to the statutorily required minimum of $10,000/20,000. The Supreme Court held that the applicable statutes and case law precluded such a "*partial disclaimer or rescission*" by the insurer, stating (p. 25): "Though *Teeter* does not preclude reformation to reduce the policy to minimum limits [citations omitted], it would be anomalous in the extreme to hold that because section 313 prohibits the insurer from asking for complete rescission it is not, in seeking reduction of the limits of its liability, disclaiming liability under subdivision 8 of section 167 of the Insurance Law [now §3420(d)(2)]. So to hold would be to permit two statutes, *both enacted to protect the public* and the insured, to cancel each other out for the benefit of the insurer" (emphasis supplied).

In affirming as to this issue, the Second Department in *Daly* said (38 AD2d at 716): 'The statutory scheme preventing rescission *ab initio* is a recognition that there is a public interest in the insurance policy which may exceed the interest of the parties to the contract (*Aetna Cas. & Sur. Co. v. O'Connor*, 8 NY2d 359). See also, *American Consumer Ins. Co. v. Durante* (N.Y.L.J. Oct. 28, 1974, p. 19, col. 3 [Sup. Ct., Kings County]), where the insurer sought reformation of a $100,000/300,000 personal liability policy to the $10,000/20,000 statutory minimum, on the ground that the issuance of its policy had been induced by fraud. In denying reformation the court not only ruled that its conclusion was required by the decision in *Reliance* supra, but also said (col. 4) that under the disclaimer statute, "the plaintiff was barred from seeking a delimitation of its policy . . . . "

In Olivio, *supra*, GEICO elected to take the risk of insuring Miss Cadogan for more than the minimum required by statute without first investigating her application. It was only after suit was brought against her for negligent operation of the insured vehicle that GEICO made the investigation, which disclosed the falsity of key statements in her application for issuance of the policy. As explained by the court, "It is now much too late for GEICO to visit upon the innocent injured plaintiffs here the effects of its failure to shoulder its burden of prompt investigation to discover the applicant's fraud." Finally, the court added that "there is language in the Vehicle and Traffic Law which reflects a clearly established legislative policy that persons injured by an insured motorist should not suffer in their ability to recover for their injuries because the insured improperly obtained liability insurance which statutorily established his financial ability to respond in damages. Thus, subdivision (2) of section 310 of the Vehicle and Traffic Law declares, 'The legislature determines that it is a matter of grave concern that motorists shall be financially able to respond in damages for their negligent acts, so that innocent victims of motor vehicle accidents may be recompensed for the injury and financial loss inflicted upon them.'"

Recent Case - McGuckin

Most recently, in *McGuckin v. Privilege Underwriters Reciprocal Exchange*, ___ AD3d ___, ___ NYS3d ___, 2019 N.Y. Slip Op. 05654 (2d Dept. July 17, 2019), the reformation/reduction issue was raised and discussed again. There, the plaintiff, Mr. McGuckin, was injured in a motor vehicle accident while riding as a passenger in a vehicle owned and operated by the Giambrones, and insured by Defendant, P.U.R.E., under a

policy with bodily injury coverage limits of $250,000 per person/$500,000 per accident. After McGuckin commenced a personal injury action against P.U.R.E.'s insureds, the Gambrones, P.U.R.E. and the Gambrones entered into an agreement to reform the policy to reduce the bodily injury coverage to a single limit of $80,000. Thereafter, the Giambrones notified McGuckin that the coverage limit applicable to the subject accident was $80,000. McGuckin subsequently obtained a judgment against the Giambrones in the amount of $300,000. McGuckin then commenced an action for a judicial declaration that the purported reformation of the policy was invalid and unenforceable, that P.U.R.E. was bound by the full bodily injury coverage limits stated in the original policy, and that, indeed, P.U.R.E. was obligated to satisfy the full amount of the judgment.[4]

In substantially modifying the Order of the Supreme Court, which had denied McGuckin's motion for summary judgment and granted P.U.R.E.'s cross-motion for summary judgment, the Second Department stated, and held, consistent with *Olivio* and *Daly*, supra, that "An insurer may not retroactively reform a policy to reduce the stated bodily injury coverage limits after a loss caused by its insured occurs, even if the reduced limits still meet or exceed the statutory minimum." Accordingly, the court held that the Supreme Court should have granted McGuckin's motion for summary judgment and denied P.U.R.E.'s cross-motion for summary judgment, and issued a declaration that P.U.R.E. was obligated to satisfy the first $250,000 of the judgment he obtained against the Giambrones.[5]

Endnotes

1. See *Integon Ins. Co. v. Goldson*, 300 AD2d 396 (2d Dept. 2002); *Ins. Co. of North America v. Kaplun*, 274 AD2d 293 (2d Dept. 2000); *Taradena v. Nationwide Mut. Ins. Co.*, 239 AD2d 876 (4th Dept. 1997); *Travelers Indem. Co. v. Avelino*, 191 AD2d 229 (1st Dept. 1993).

2. The statute was amended in 1958 to provide for 20 days' notice of termination except in case of nonpayment of premium, in which case a 10-day notice would suffice [L. 1958, ch. 661]. The statute was further amended to increase the required notice for a non-payment cancellation to fifteen days.

3. See *Government Employees Ins. Co. v. Allen*, 95 AD3d 1322 (2d Dept. 2012); *Global Liberty Ins. Co. of New York v. Pelaez*, 84 AD3d 803 (1d Dept. 2011); *General Assurance Co. v. Rahmanov*, 56 AD3d 332 (1st Dept. 2008); *MetLife Auto & Home v. Agudelo*, 8 AD3d 571 (2d Dept. 2004); *Ins. Co. of North America v. Kaplun*, 274 AD2d 293 (2d Dept. 2000); *Mooney v. Nationwide Mut. Ins. Co.*, 172 AD2d 144 (3d Dept. 1991); *Fireman's Fund Ins. Co. v. Corcoran*, 156 AD2d 167 (1st Dept. 1989).

4. McGuckin also interposed a cause of action to recover his attorney's fees and expenses incurred in connection with the Declaratory Judgment action he commenced -- to which he was not entitled pursuant to the well-established rules pertaining to attorneys' fees in Declaratory Judgment actions. See *Mighty Midgets v. Centennial Ins. Co.*, 47 NY2d 12, 21-22 (1979).

5. Insofar as McGuckin failed to demonstrate any basis on which P.U.R.E. would be obligated to pay more than its policy limits, the court rejected his attempt to collect the full $300,000 judgment from P.U.R.E.

Jonathan A. Dachs is a partner at Shayne, Dachs, Sauer & Dachs, LLP, in Mineola. He is the author of *New York Uninsured and Underinsured Motorist Law & Practice* (LexisNexis/Matthew Bender 2016, 2017, 2018).