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Key Lessons From Recent Insurance Policy Reform Litigation

By **Jad Khazem and Seth Tucker** (May 23, 2024, 5:33 PM EDT)

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As insurance policies continue to increase in size and complexity, it has become more labor-intensive than ever to ensure that a policy properly reflects the intentions of the contracting parties.

Where it does not, policyholders — and, at times, insurers — have looked to policy reformation and other remedies to vindicate the parties' intended bargain. Indeed, in the past five years alone, more than 360 appellate and trial court decisions have addressed or otherwise referenced policy reformation arguments.[1]

These recent decisions highlight the wide range of misunderstandings that may arise between insurers and policyholders in the purchase and renewal of insurance policies — as well as the utility, and the limits, of reformation and related remedies as solutions for these misunderstandings.

The questions courts have faced in such cases have included:

- Is the policyholder bound by policy changes that its insurer failed to call attention to in the placement process?
- Can a policy be reformed to address a mistake that is the policyholder's alone?
- Does the reformation of an error in a primary policy affect the scope of coverage of excess policies?

This article addresses these and related questions, with a focus on policy reformation case law over the past five years. Specifically, this article analyzes typical misunderstandings that may prompt reformation litigation, and identifies remedies available to address such issues.

Common Reformation Battlegrounds

Below, we discuss common types of errors and misunderstandings that, if not caught in the policy placement process, all too often lead to policy reformation disputes.

Subtle Wording Changes

Seemingly minor changes in policy language that work major reductions in coverage are, unsurprisingly, a common source of controversy.

In one illustrative 2020 case, Pilkington North America Inc. v. Mitsui Sumitomo Insurance Co. of America, decided by the U.S. District Court for the Southern District of New York, an insurer allegedly covertly expanded a windstorm sublimit to apply to "U.S. windstorms" generally, rather than to a windstorm caused by a named storm.

One alleged effect of this change was to drastically reduce the policy's coverage for ordinary tornadoes of the type common in the middle of the U.S. The limit available to the policyholder following a garden-variety tornado plummeted from the full $320 million limit of the policy to the $15 million windstorm sublimit.

The court ruled that the policyholder successfully pled a claim for reformation to restore the narrower language, which would render the sublimit inapplicable to a tornado that struck after the policy language had changed and that, while catastrophic, was not caused by a named storm."[2]

Changes in Calculation Methodology

Policyholders have also litigated changes affecting how insured losses are quantified.

For instance, in 2021, in Johnson v. Pennsylvania National Mutual Casualty Insurance Co., a dispute over coverage for lead paint liabilities, the U.S. District Court for the District of Maryland held that a policyholder successfully pled a claim for reformation to add to its policy an inadvertently omitted endorsement that amended a $1 million aggregate limit to apply per location.[3]

In 2021, in Roc Nation LLC v. HCC International Insurance Co., a dispute concerning a claim under a critical-asset-protection policy, the insurer successfully argued that the relevant loss definition had to be reformed to permit subtraction of certain revenue traceable to the "insured person" — a key business generator — as opposed to revenue traceable to the "insured," a corporate entity.

But the Southern District of New York went on to largely rule against the insurer in its coverage calculation under the reformed provision.[4]

Changes Affecting the Meaning of Preexisting Provisions

A post-Hurricane Sandy appellate decision from New Jersey highlights the need to review not only revised policy language, but also how any revisions might affect the meaning or operation of other policy provisions.

In New Jersey Transit Corp. v. Certain Underwriters at Lloyd's London, in 2019, the New Jersey Appellate Division construed a flood sublimit to not apply to water damage resulting from storm surge associated with a named windstorm, because a newly added provision in the policies made a named windstorm a separately defined peril.[5]

One insurer sought reformation, arguing that it was misled to believe that the named windstorm definition — which was added to its policy at renewal via endorsement — would not affect the flood sublimit — though the insurer's reformation claim failed for lack of evidence of misrepresentation.[6]

Identity of Insureds

In 2021, in Prospect JV Development LLC v. Illinois Union Insurance Co., the U.S. District Court for the Eastern District of New York surveyed decisions permitting reformation to identify the proper insured. It found that this problem had arisen in multiple contexts, including:

- An officer misidentifying the name of the corporate insured;
- A mortgage holder assigning its interest in property to another entity without advising the insurer; and
- A policy incorrectly identifying a subtenant as the owner of the insured property.[7]

Based on that authority, the Prospect JV court reformed the policy to institute a joint venture limited liability company as the insured owner of a property — replacing a member of the venture mistakenly listed as owner — notwithstanding that the error "was due to Plaintiffs', not Defendants' mistake."[8]

At a time when corporate identities and interests in properties regularly change and errors in policy placement occasionally ensue, reformation — if available — may be a useful tool to clarify who exactly the insured is that is entitled to recover.

Scrivener's Errors

Insurance policies are not immune from scrivener's errors. In one 2019 coverage dispute following a helicopter crash, Farrar v. American National Property & Casualty Co., it was discovered that the parties had mistakenly excluded coverage for "Hazard Division 1: Airport Operations" by incorrectly listing under the Hazard Division 1 coverage grant an exception for liability arising out of "Hazard Divisions 1 through 4" instead of "Hazard Divisions 2 through 4."

Based on evidence of the intent of the parties, the U.S. District Court for the Eastern District of California reformed the policy to track the latter phrasing — i.e., it swapped "1" with "2" — thereby effectuating those intentions.[9]

Policy Reformation and Related Remedies

Recent case law underscores that the equitable remedy of contract reformation may be available to revise an insurance policy when its terms differ from what the policyholder believed it was buying.

Moreover, policyholders may also be able to avail themselves of several other potential remedies when there is a disconnect between the policy as promised and the policy as issued.

Reformation Addressing Mutual Mistake

A quintessential case for application of the reformation remedy is to revise a policy to correct a mutual mistake — traditionally, an error in the terms of a policy unnoticed by both insurer and insured. This remedy has been used to respond to issues ranging from a coverage-stripping typo[10] to an inadvertently omitted endorsement.[11]

Moreover, as the Southern District of New York recognized in 2021, in 282 Mountainview Drive LLC v.

Norguard Insurance Co., some courts have expanded the mutual-mistake doctrine to permit reformation even in cases involving seemingly unilateral errors made by applicants for insurance, where the evidence showed that the insurer "would have insured the risk" had "correct information been provided."[12]

Reformation Addressing Fraudulently Induced Unilateral Mistake

Policyholders have also gained traction in seeking to reform policy terms allegedly procured by insurer fraud, deceit or other inequitable conduct.

For instance, in the Pilkington case, the district court held that the policyholder had successfully stated a claim for reformation of the windstorm sublimit when it alleged that the revised windstorm sublimit:

- Had been pushed through via a mid-policy-period endorsement;
- Was not called to the attention of the broker in correspondence presenting the endorsement;
- Was presented as part of a package that the insurer represented made only noncontroversial valuation changes; and
- Was expressly accepted by the broker on the basis of the insurer's representation.[13]

Reformation for Unannounced Changes at Renewal

Certain jurisdictions have placed a duty on the insurer to call out any changes in renewal policies, on the understanding that renewal policies typically cover the same terms and conditions as the prior policy unless otherwise specified.[14]

In jurisdictions in which this rule applies, where the insurer fails to adequately alert the insured of a change in a renewal policy, the original policy provisions will govern if they are more favorable to the policyholder than the new provisions.

This was the case in Gieringer v. Cincinnati Insurance Co., where the U.S. District Court for the Eastern District of Tennessee held in 2010 that exceptions to a sublimit that were removed, but were not adequately announced, at renewal remained part of the policy.[15]

As the Couch treatise recently described this doctrine:

The law does not impose upon the insured under a renewal policy the duty to inspect such renewal policy, and failure of the insured to examine his or her new policy when it was delivered to him or her, which would have led him or her to discover an added clause, does not defeat recovery under the terms of the original policy where the insurer did not inform him or her that the renewal policy would in any way be different from the original.[16]

Reformation of Follow-Form Policies

As the Delaware Superior Court observed in 2021, in Conduent State Healthcare LLC v. AIG Specialty Ins. Co., courts in several states "have held that a reformation to a primary policy can be binding on excess insurers who follow form."[17] Application of this principle is not universal, however.

For example, the Conduent State Healthcare court — while acknowledging this general principle —

declined to apply it where the excess insurers' policies stated that the excess insurers would be bound only by changes to the primary policy to which they assented, and the primary policy had been, in the insured's words, "reformed" to "fix an error," not by court order, but via an amendatory endorsement to which the excess insurers had not consented.[18]

Equitable Estoppel

Where an insurer knowingly conceals or misstates facts, and intends or expects that its concealment or misstatement will be relied upon, the insurer may be estopped from taking a position inconsistent with its omission or misstatement.[19]

This principle may be applied, for example, to estop an insurer from limiting coverage based on an allegedly deceitfully revised sublimity, as in Pilkington.[20]

It may also be applied to estop an insurer from enforcing an anti-assignment clause where the insurer allegedly renewed the policy notwithstanding knowledge of the assignment, and also collected premiums from the assignee — as in One Beacon Insurance Co. v. Old Williamsburg Candle Corp., a 2005 decision by the Southern District of New York.[21]

Many states purport to bar use of estoppel to expand the scope of coverage, but according to the 2019 Restatement of the Law of Liability Insurance, a "substantial body of caselaw" has developed permitting such use "largely in the context of misrepresentations" at the time of sale.[22]

Insurer Bad Faith

Where coverage restrictions are alleged to have been procured fraudulently or inequitably, a policyholder may be able to bring claims for insurer bad faith on the ground that the insurer "injured its right to receive one of the contract's fundamental promises by covertly reducing the scope of coverage," as the Southern District of New York held in 2020 in Pilkington.[23]

More recently, in 2022, in Lowery v. AmGuard Insurance Co., the U.S. District Court of the Northern District of Georgia denied an insurer motion for summary judgment regarding a claim of insurer bad faith, where the court could not conclude that a coverage denial was "reasonable" where the insurer had denied coverage — for lack of a proper insured — to an entity it readily accepted premiums from, and that was accordingly included as an insured via equitable reformation.[24]

Such bad faith claims may potentially expand the damages available to the policyholder above and beyond a simple contractual recovery on the reformed policy.

Remedies Against an Insurance Broker

Policyholders may also seek to hold their brokers accountable for errors in the insurance policy, including by asserting claims for failure to adequately advise the insured in the placement of insurance, or for misrepresentation of the scope of coverage.[25]

To be sure, brokers often include limitation-of-liability clauses in their contracts in an effort to cap their exposure for such claims.[26] But policyholders may, in some circumstances, be able to argue that such provisions should not be enforced due to intentional, reckless or grossly negligent conduct on the part of the broker.[27]

Relevant Evidence Courts Consider in Reformation Cases

Courts adjudicating reformation disputes have considered, among other things, whether premiums were paid in respect of the allegedly inadvertently omitted coverage,[28] whether the revised term changed a long-standing policy provision,[29] and whether the insurer made certain misleading representations, or failed to correct clearly expressed misunderstandings by the policyholder, in placing the insurance program.[30]

Evidence of policyholder sophistication is often argued as a defense against reformation. But such evidence is hardly dispositive — and reformation claims have been permitted to proceed even for insureds represented by brokers.[31]

Conclusion

As insurance policies continue to evolve and expand, policyholders must be adept at responding to those situations where a policy purchased — due to fraud, inadvertence or otherwise — does not reflect the intended bargain.

Reformation case law in recent years highlights the increasing opportunities and arguments available to policyholders to bring their policies in sync with their contracting intentions — and to hold accountable those responsible for any gap between the expected coverage and the policy as issued.

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[1] Based on Westlaw search dated May 20, 2024, of "policy /s reformation" cases since May 1, 2019, filtered by "Practice Area: Insurance".

[2] Pilkington N. Am. Inc. v. Mitsui Sumitomo Ins. Co. of Am., 460 F. Supp. 3d 481, 492-97 (S.D.N.Y. 2020). The authors represented the policyholder in this case.

[3] Johnson v. Pennsylvania Nat'l Mut. Cas. Ins. Co., 447 F. Supp. 3d 372, 376, 380-83 (D. Md. 2020).

[4] Roc Nation LLC v. HCC Int'l Ins. Co. PLC, 523 F. Supp. 3d 539, 560-72 (S.D.N.Y. 2021).

[5] New Jersey Transit Corp. v. Certain Underwriters at Lloyd's London, 221 A.3d 1180, 1188-90 (N.J. App. 2019), aff'd, 243 A.3d 1248 (N.J. 2021).

[6] Id. at 1194-96.

[7] Prospect JV Development LLC v. Illinois Union Insurance Co., 2021 WL 5066592, at *3-4 (E.D.N.Y.

Sept. 27, 2021) (collecting cases).

[8] Id.

[9] Farrar v. American Nat'l Prop. & Cas. Co., 2019 WL 2369930, at *7-8 (E.D. Cal. June 5, 2019).

[10] Id.

[11] Johnson, 447 F. Supp. 3d at 380-81.

[12] 282 Mountainview Drive LLC v. Norguard Ins. Co., 2021 WL 3037450, at *7 n.3 (S.D.N.Y. July 14, 2021) (collecting cases).

[13] Pilkington, 460 F. Supp. 3d at 492-97.

[14] E.g., Smith v. American Nat'l Prop. & Cas. Co., 508 F. Supp. 3d 1048, 1061-62 (N.D. Okla. 2020); Gieringer v. Cincinnati Ins. Co., 2010 WL 1050201, at *3 (E.D. Tenn. Mar. 22, 2010).

[15] Gieringer, 2010 WL 1050201, at *5-6.

[16] Couch on Ins., Inclusion of New Provisions § 29:42 (3d ed. Nov. 2023) (footnote omitted).

[17] Conduent State Healthcare LLC v. AIG Specialty Ins. Co., 2021 WL 2660679, at *7 & n.23 (Del. Super. June 23, 2021) (collecting cases).

[18] Id. at *7-8.

[19] Pilkington, 460 F. Supp. 3d at 497-98 (holding that insured had pled a sufficient estoppel claim).

[20] Id.

[21] One Beacon Ins. Co. v. Old Williamsburg Candle Corp., 386 F. Supp. 2d 394, 401 (S.D.N.Y. 2005).

[22] Restatement of the Law of Liability Insurance § 6 note (e) (2019) (citation omitted).

[23] Pilkington, 460 F. Supp. 3d at 498.

[24] Lowery v. AmGuard Ins. Co., 629 F. Supp. 3d 1296, 1308-10 (N.D. Ga. 2022), aff'd, 90 F.4th 1098, 1101-1103 (11th Cir. 2024) (sustaining reformation, while noting that the insured had withdrawn the bad faith claim to obtain final judgment without trial).

[25] E.g., Pilkington N. Am. Inc. v. Mitsui Sumitomo Ins. Co. of Am., 420 F. Supp. 3d 123, 139-40 (S.D.N.Y. 2019); Shulman v. Concord Gen. Mut. Ins. Co., 618 F. Supp. 3d 165, 178 (D. Vt. 2022).

[26] E.g., Aon, Commercial Risk Solutions U.S. Business Terms, https://www.aon.com/about-aon/corporate-governance/guidelines-policies/ars-disclosures-commitments (accessed May 20, 2024).

[27] 2 Modern Tort Law: Liability and Litigation § 21:4 (2d ed. May 2024).

[28] Farrar, 2019 WL 2369930, at *7; Lowery, 629 F. Supp. 3d at 1308.

[29] Johnson, 447 F. Supp. 3d at 381.

[30] Pilkington, 460 F. Supp. 3d at 494.

[31] E.g., id. at 492-97; Prospect JV, 2021 WL 5066592, at *2.