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## *Flown!* *Empty.* **CANCELLED.**

**A Bird's Eye View of  
Circular Letter 23**

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**COVER** By Sari Gabay-Rafi

# *Flown!* *Empty.* **CANCELLED.**

**Here's A Bird's Eye View  
of Circular Letter 23.**



Sari Gabay-Rafi





## The legislative intent behind Section 3425 is to protect the insured from unwarranted cancellations.

*Can an insurance company cancel your homeowner's policy if you leave your New York home unoccupied during the winter months in order to spend the season in a warmer climate? Apparently, many insurance companies have cancelled homeowners' policies claiming either that an unoccupied residence constitutes (a) a "physical change" in the property insured or (b) a willful or reckless act or omission increasing the hazard insured against.*

Under Section 3425 of New York Insurance Laws, an insurance company may cancel a homeowners' policy by issuing a cancellation notice during the first 60 days the policy is in effect provided the cancellation notice states the specific reason(s) for the cancellation.

However, after the initial 60 day period has expired, an insurance company may not cancel or decline to renew a homeowners' policy for three years, except for very limited reasons.

The legislative intent behind Section 3425 is to protect the insured from unwarranted cancellations. Historically, policyholders were protected against cancellation only with respect to automobile liability insurance. As stated in the Memorandum of the State Executive Department in drafting Section 3425:

Although prompt cancellation of an insurance policy during its term can work great hardship on the policyholder, cancellations based on reasons that are not the policyholder's fault or are beyond his control are permitted by law and do occur, too often, in practice. To assure fair treatment of policyholders by insurance companies, this bill would extend legal protection against mid-term cancellation to all personal property-liability lines.

Against this backdrop, Section 3425 was enacted to govern cancellation and renewal of most non-commercial property/casualty insurance policies, including homeowners' policies which are considered "personal lines insurance."

Under Section 3425, once the 60 day period has passed, an insurance company can only cancel a homeowners' policy for one of the following six limited reasons:

1. nonpayment of premium (unless the insurer receives payment within

15 days of the mailing of the cancellation notice);

2. conviction of a crime arising out of acts increasing the hazard insured against;

3. discovery of fraud or material misrepresentation in obtaining the policy or in the presentation of a claim under the policy;

4. discovery of willful or reckless acts or omissions increasing the hazard insured against;

5. physical changes in the property insured occurring after issuance or last annual anniversary date of the policy which result in the property becoming uninsurable in accordance with the insurance company's objective, uniformly applied underwriting standards in effect at the time the policy was issued or last voluntarily renewed; or

6. a determination by the Superintendent of Insurance that the continuation of the policy would violate or would place the insurer in violation of the Insurance Law.

Insurers have apparently relied on two of those six reasons in order to cancel homeowners' policies for being unoccupied claiming either that an unoccupied residence constitutes (1) a "physical change" in the property insured or (2) a willful or reckless act or omission increasing the hazard insured against.

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## Physical Changes in the Property Insured

What constitutes a "physical change" to the property? The Office of General Counsel has opined that a "physical change" occurs only when the dwelling or property has been altered or changed in some manner. See OGC Op. No. 04-11-20, November 29, 2004. For instance, the Department has concluded that the addition of an in-ground swimming pool constitutes a significant alteration to the permanent structure of the property that satisfies the "physical change" requirement of Section 3425(c)(2)(E).

On the other hand, the Department has opined that the addition of a business to a home, without any physical alterations to the structure of the property itself, is not a "physical change." That is, the mere addition of a home business would not constitute a "physical change" to the property except if there have been alterations to the property resulting in the property becoming uninsurable in accordance with the insurer's uniformly applied underwriting standards.

The few Office of General Counsel Opinions addressing the meaning of "physical change" apparently left room for interpretation with respect to whether an unoccupied home could constitute a "physical change."

### Circular Letter No. 23

On November 19, 2008, in response to numerous complaints received by the

New York State Insurance Department from insureds whose homeowners' policies were canceled on the grounds that lack of occupancy constituted a "physical change," the Department issued Circular Letter No. 23. In the Circular Letter, the Department set the record straight that "[t]he fact that an insured is not occupying a residence does not constitute a physical change to the premises within the meaning of section 3425(c)(2)(E)."

The Department's investigation determined that a number of insurers, after determining that residences had become unoccupied, improperly cancelled the owners' policies on grounds that the lack of occupancy constituted "physical changes" within the meaning of § 3425(c)(2)(E).

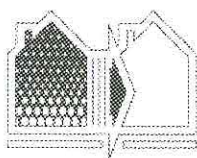
In the Circular Letter, the Department clarified that Insurance Law § 3425(c)(2)(E) applies only when there has been an actual physical change to the property that renders the property uninsurable in accordance with the insurer's underwriting guidelines. "Physical change occurs only when the dwelling or property has been altered or changed in some manner." See Opinion of Office of General Counsel No. 04-11-20, November 29, 2004. The Department concluded that the fact that an insured is not occupying a residence does not constitute a physical change to the premises within the meaning of § 3425(c)(2)(E).

Based upon this Circular Letter, insurers may not use the "physical change" exception as a reason to issue a mid-term cancellation of a homeowners' policy on an unoccupied residence.

**The insurance company issued a mid-term cancellation notice one week after the policy was up for renewal. The Department concluded that the insured's actions, given the circumstances of her hospitalization, were not willful or reckless.**

### Willful or Reckless Acts or Omissions Increasing the Hazard Insured Against

What constitutes a willful or reckless act or omission increasing the hazard insured against? There are no bright line rules in this area and Office of General Counsel Opinions and case law on the

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subject are scarce. The Department has explained that "if the insured's act or omission results in an insignificant or minor increase in risk, it should not trigger cancellation on the grounds that it was willful and reckless." See OGC Op. No. 04-11-20, November 29, 2004. But, "[a]ssuming that the property becoming unoccupied means that the hazard increases, whether the insured has engaged in 'willful or reckless acts or omissions' depends upon the specific facts." See OGC Op. No. 04-04-21, April 22, 2004.

The Department has opined that circumstances beyond the insured's control such as an extended hospital stay, a move to a nursing home, or a home foreclosure, does not constitute a willful or reckless act or omission.

For example, in an April 22, 2004 Opinion, the Department was faced with the issue of an insured who became ill and was hospitalized and had therefore left her home unoccupied for several months. The insurance company learned that she had left her home unoccupied when a claim was made about three months after she entered the hospital and at a time when the home still remained unoccupied. The insurance company issued a mid-term cancellation notice one week after the policy was up for renewal.

**There are several factors that may be relevant in determining whether leaving a residence unoccupied for an extended period increases the hazard insured against.**

The Department concluded that the insured's actions, given the circumstances of her hospitalization, were not willful or reckless. However, the Department insinuated that there may be other situations where the property becomes unoccupied as the result of willful or reckless acts or omissions. See OGC Op. No. 04-04-21, April 22, 2004.

Recently, on September 10, 2008, the Department opined that an insurer may not cancel a homeowner's insurance policy based solely on notification by the bank of an impending or commenced foreclosure action. See OGC Op. No. 08-09-02. The filing of a foreclosure action does not constitute a "willful or reckless act or omission," or "increas[e] the hazard insured against." In relying on a prior opinion, the Department explained that the increase in the "hazard insured against" as a result of a "willful or reckless" act, or an omission that triggers an insurer's right to cancel, must be more than a minor or insignificant increase." *Id.*

But unlike an unexpected hospital stay or an unavoidable home foreclosure, can the conscious decision to relocate for the winter months be considered willful or reckless? The answer is not entirely clear.

The Department has opined that although "willful" is generally defined as "merely a knowing act," acts that a homeowner is aware of and intends such as purchasing a trampoline, adding an above-ground pool, or operating a home business, do not necessarily rise to the level of willful or reckless under Section 3425(D). See OGC Op. No. 04-11-20, November 29, 2004.

The addition of an above-ground swimming pool or a trampoline, may however, warrant a mid-term cancellation if the insured fails to take ordinary and proper safety precautions, such as installing a fence around the pool or trampoline. This is particularly true of the insured is on notice of the increased hazard or danger but fails to take appropriate safety measures. Likewise, if an insured operated a home business in an unsafe or unlawful way, or if the insurer has advised the insured that a business would violate the insurer's underwriting guidelines, then such conduct may be considered reckless or willful and therefore, grounds for a mid-term cancellation.

Keep in mind that as the Department pointed out in Circular Letter No. 23, in order to cancel a policy based upon a "willful or reckless act," the act or omission must also "increase the hazard insured against."

In determining whether having a trampoline or an above-ground pool increases the hazard insured against the Department considered whether some insurers charge more or have specific exclusions for those items. See OGC Op. No. 04-11-20, November 29, 2004. In other words, if the willful or reckless act is excluded under the policy, then the policy cannot be cancelled by reason of the willful or reckless act, because the act was never covered under the policy. Assuming, hypothetically, that a homeowner's policy contained an exclusion for unoccupied premises, there is no increased insurance risk if the insured leaves the premises unoccupied for the season.

There are several factors that may be relevant in determining whether leaving a residence unoccupied for an extended period increases the hazard insured against. For instance, whether or not the insured cut off water, gas or electricity or exercised proper safety measures may increase the hazard insured against.

Circular Letter No. 23 makes clear that becoming a snowbird and leaving a residence unoccupied is not, in and of itself, a proper ground for a mid-term cancellation. But it does not answer what conduct or lack of conduct, when flying south for the winter, is so willful or reckless that it warrants a permissible cancellation. Until there is more from the Department in this area, be sure to set the thermostats and alarm systems, have the home periodically checked on, and be wary of increasing any hazards or you may really leave your property in the cold. [A]

*This article is for informational purposes only and is not intended to give legal advice. For more information, please contact the author at 212-941-5025 or gabay@gabaybowler.com. Gabay-Rafly & Bowler LLP handles a wide range of insurance regulatory matters before the New York State Insurance Department as well as all stages of commercial litigation in New York State and federal courts.*