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VIEWPOINT

Lapse in security leads to lapse in coverage for disappearing diamond

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A "brilliant" recent decision from the Appellate Division, First Department once again highlights the need for businesses to be aware of the conditions precedent contained in their insurance policies so as to ensure that coverage will be available in the event of a loss.

A condition precedent is a requirement contained within an insurance policy that must be satisfied before coverage can be triggered. In other words, the policyholder must fulfill these requirements or else the insurer may not have any obligation to cover a claim. Under New York Insurance Law § 3106, provisions which operate as a condition precedent to coverage are deemed to be warranties made by the policyholder. A breach of warranty can result in the loss of coverage so long as a breach of the warranty would materially increase the risk of loss, damage or injury within the coverage of the contract. For example, a commercial property insurance policy insuring against loss due to fires might contain a provision requiring that the insured premises have operable fire alarms and/or fire suppression systems. If the insured breaches that warranty (by failing to maintain the fire alarm systems), that breach could increase the risk of loss to the insurer in the event of a fire, and therefore would be grounds for the insurer to disclaim coverage.

In *Certain Underwriters at Lloyd's v. Itzhak Nissanoff Inc.*, the First Department affirmed the trial court's order granting summary judgment to the plaintiff insurer and declaring that the insurer had no duty to defend or indemnify the defendant insureds in an underlying lawsuit stemming from the disappearance of a diamond. The dispute turned on the application of a condition precedent requiring the insured to maintain a fully operable security system.

The Appellate Division's brief decision did not delve into the fascinating history of the dispute that lead to the insurance claim. For additional "color," we reviewed the record of the proceedings below in the Commercial Division. The insured operated a diamond business in New York's Diamond District. In 2017, the insured took custody of a nearly 30-carat diamond that was to receive a high-pressure high-temperature (HPHT) treatment (a process intended to enhance the color and clar-

ity of natural diamonds). The insured alleged that it shipped the diamond back to its owner in India, but the diamond's owner claimed not to have received the diamond. The parties fiercely disputed whether the diamond had in fact been lost or stolen, or whether the diamond's owner — allegedly displeased that the diamond had not obtained the desired color and clarity following the HPHT treatment — had fraudulently reported it stolen. The diamond's owner brought suit against the insured, which was removed to arbitration.

The insured reported the claim and sought defense and indemnity under its commercial property policy. The insurer denied coverage and commenced an action seeking a declaration that the insured was not entitled to coverage.

The insurer focused on the policy's Alarm and Protection Clause, which stated that, as a condition precedent to coverage, the premises containing insured property must be equipped with a burglar alarm that must be maintained in good order and fully operable, and that the security system not be altered or varied without the insurer's consent. As described by the insurer, the essence of the Alarm and Protection Clause was to ensure that the insureds would safeguard the valuable property taken into their custody.

At the time of the loss, the insured's burglar alarm system was no longer working, having fallen out of order approximately one month before the loss. The insured testified that the security cameras had frozen like "ice," and had not been repaired prior to the date of the loss.

On appeal, the insured attempted to rely on New York Insurance Law § 3420(d) to argue that by failing to issue a prompt disclaimer, the insurer had waived the ability to disclaim coverage. But the First Department rejected that position, noting that by its terms, Insurance Law § 3420(d) applies only to denials of coverage for death or bodily injury, and was therefore inapplicable to the property insurance claim at issue. In any event, the insurer had sent an explicit reservation of rights letter and the insured was not prejudiced, because the requirement to maintain an operational security system was explicitly stated within the policy.

The insured further argued that the non-functioning security cameras did not constitute a breach of the Alarm and Protection Clause, because other portions of the security system remained functional. But the First Department found that the Alarm and Protection Clause was a model of "clarity," insofar as it "plainly pertains to the entire burglar alarm system at issue, including the security cameras, which must be operable at all times," and that the provision was material to the risk of loss under the policy.

The *Itzhak Nissanoff* case is just the latest example of why policyholders should periodically review their policies to ensure that they are aware of all of the conditions that apply to their coverage and that they are in compliance with those conditions. If you are unsure about a condition in your policy, seek advice from legal counsel or consult your insurance broker. Don't wait for your insurance carrier to "cut" your coverage after a loss because of a failure to satisfy a policy condition!

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