

Insurer Did Not Waive Ability to Rescind by Accepting Premiums

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A federal district court, applying New York law, held that where an application for a legal malpractice policy failed to disclose the existence of 28 potential claims, as well as the fact that the prospective insured was being investigated by a state disciplinary committee, the application contained material misrepresentations justifying rescission. *Chicago Ins. Co. v. Kreitzer & Vogelman*, 2003 WL 21262077 (S.D.N.Y. June 2, 2003). The court also held that the insurer did not waive its right to rescind by accepting premiums for tail coverage after learning of some, but not all, of the facts that ultimately led it to sue for rescission.

An insurer brought this action, seeking a declaration that it properly rescinded two policies that it had issued to a New York law firm. After hearing evidence, the court made several findings of fact, including that although the law firm had identified in its application for coverage five claims pending against it, it had failed to disclose 28 potential claims and it did not answer a question concerning pending disciplinary proceedings, even though the state disciplinary committee was investigating the policyholder's managing partner. On the following year's renewal application, the policyholder again failed to report the disciplinary proceedings and approximately 30 potential claims. The court also found that the law firm had later informed the insurer of the managing partner's suspension resulting from the disciplinary proceedings. Aware of the suspension and of 10 claims that had been pending against the policyholder, the insurer nevertheless accepted premiums for an endorsement granting tail coverage. In the six months that followed, the insurer received notice of the additional claims, investigated the claims, and explored a potential rescission action. The insurer ultimately rescinded the policies and the accompanying tail coverage, and tendered all premiums.

In light of these findings of fact, the court first concluded that the policyholder's misrepresentations and omissions were material and justified rescission of the policies. The court reasoned that the insurer had successfully proved that if it had known about the disciplinary proceedings and additional claims, it either would have issued the policies under different terms and premiums or would not have even issued the policies.

The court also held that the insurer had not waived its ability to rescind the policies by accepting payments for tail coverage even after it learned of some of the omissions. The court reasoned that the insurer's knowledge of the managing partner's suspension from the practice of law and the presence of 10 claims against the policyholder "was not sufficient knowledge of the grounds for rescission such that [the insurer]

waived its rights to rescind" when it accepted premiums for tail coverage. The court rejected the policyholder's argument that the insurer's failure to investigate the blank answer on the renewal application constituted a waiver, reasoning that an insurer does not have a duty to investigate or verify information supplied by a policyholder. Moreover, the insurer's six-month investigation into whether grounds for rescission existed also did not cause a waiver, as case law and public policy "support[] the allowance of such a reasonable investigation."

The court also rejected the policyholder's argument that the insurer was estopped from rescinding the policies because the policyholder had detrimentally relied on the insurer's acceptance of premiums by not acquiring tail coverage from the prior insurer. The court explained that the argument failed because the policyholder would not have been able to obtain tail coverage from its prior insurer at the relevant time in light of the additional claims.

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