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NEWSLETTER

Malpractice Insurer Entitled to Rescission of Policy Based on Lawyer's Fraud

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A New Jersey intermediate appellate court, applying that state's law, has held that an insurer was entitled to rescission of a claims-made malpractice insurance policy because the attorney-policyholder's answer to a question in his insurance application regarding knowledge of potential claims was knowingly false. *Liebling v. Garden State Indem.*, No. A-2940-99T1, 2001 N.J. Super. LEXIS 70 (App. Div. Mar. 1, 2001). Moreover, the court determined that an exclusion for claims of which "any insured, at the inception date of this contract, knew or reasonably could have foreseen . . . might be expected to give rise to a claim otherwise insured" would also bar coverage for the malpractice claim against the lawyer.

The policyholder, an attorney, sought coverage for a malpractice suit against him arising out of the dismissal of a complaint filed by his client based on a failure to prosecute. The attorney had taken over the case from another firm, which previously had filed the client's case against improper parties. The attorney failed to amend the complaint within the time period allowed, and the complaint was dismissed with prejudice against his client. The attorney assertedly attempted to contact his client for several months to "discuss" the case, but was unsuccessful. Subsequently, the attorney applied for malpractice insurance and responded "no" to a question regarding whether the attorney "was aware of any circumstances, or any allegations or contentions as to any incident which may result in a claim being made against the firm." The policy was issued. Thereafter, the client sued, and the policyholder sought coverage. The insurer disclaimed coverage and sought rescission of the policy on the grounds of a material misrepresentation.

The intermediate appellate court determined that a claim for equitable fraud requires proof of: (1) a material misrepresentation of a presently existing or past fact; (2) the maker's intent that the other party rely on it; and (3) detrimental reliance by the other party. In most cases, a party's knowledge of the falsity of the statement is irrelevant. However, in the context of an insured's answers to questions posed on insurance applications, the court made a distinction between objective and subjective questions. With subjective questions, i.e., "one that seeks to probe the applicant's state of mind," equitable fraud is present only if the answer was knowingly false. Here, the court determined that the policyholder's answer on the application was knowingly false because the attorney could not reasonably have believed that his client was not likely to bring a malpractice claim against him for breach of his professional duty. Accordingly, the court concluded that rescission was appropriate.

The court also determined that an exclusion for claims of which "any insured, at the inception date of this contract, knew or reasonably could have foreseen . . . might be expected to give rise to a claim otherwise insured here" would also have barred coverage for the malpractice claim against the lawyer. The court determined that the "reasonably could have foreseen" exclusion only barred coverage if the insured "knew or believed that there had been a deviation from professional standards and that based on all the known circumstances it was likely that a malpractice claim would be made." Because the attorney could not have reasonably believed he was secure from a malpractice claim, the court held that, even in the absence of rescission of the policy, the exclusion would have barred coverage.