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NEWSLETTER

Insurer Rescinds Law Firm's Professional Liability Policy Based on Material Misrepresentations in Policy Application

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In an unpublished opinion, the United States Court of Appeals for the Sixth Circuit, applying Michigan law, has upheld a district court decision allowing an insurer to rescind a law firm's professional liability policy based on material misrepresentations in the policy application. *Am. Guarantee & Liab. Ins. Co. v. The Jaques Admiralty Law Firm, P.C.*, 2005 WL 20369 (6th Cir. Jan. 4, 2005).

The application for the professional liability policy at issue asked "[d]oes any lawyer . . . know of any circumstances, acts, errors or omissions that could result in a professional liability claim against any attorney of the firm, the firm, or its predecessors?" The vice president of the law firm, who completed the application on behalf of the firm, answered "No." On the basis of this and other representations by the firm, the insurer issued the policy. In connection with a renewal of that policy, the renewal application asked "whether any attorney was aware of any claim, incident, act or omission in the last year which might reasonably be expected to be the basis of a claim or suit arising out of the performance of professional services for others." The response again provided was "No," and the insurer renewed the policy. Subsequently, after the sudden and unexpected death of the senior partner of the law firm, the other attorneys of the firm discovered that the senior partner had misappropriated approximately $15 million in settlement funds due to the firm's clients during the past decade.

The insurer subsequently filed an action to rescind the firm's professional liability policy, arguing that the deceased senior partner's knowledge of his misappropriation constituted knowledge of circumstances that could result in a claim, rendering the policy application responses materially misleading. The district court agreed and granted the insurer's motion for summary judgment.

On appeal, the court of appeals first determined that the case was governed by Michigan common law, rather than the statutory provision, M.C.L.A. § 500.2218, relied on by the district court. According to the appellate court, the statute was limited to "the types of insurance explicitly included in the statutes' purview [disability, life, health and accident insurance]," and thus Michigan common law applied.

Nonetheless, the court "summarily reject[ed] as unfounded [the insured firm's] contention that a material misrepresentation is a necessary but insufficient precondition to rescission under Michigan law." The appellate court noted, however, that Michigan courts have not addressed whether a material misrepresentation by one insured is sufficient grounds for rescission as to so-called "innocent insureds" who did not participate in the incorrect response. Reviewing case law from other jurisdictions, the court held that "the prevailing rule . . . is that a misrepresentation by an insured in an application for insurance permits rescission even as to innocent insureds." The Sixth Circuit rejected the policyholder's invitation to adopt a contrary minority rule, stating "our assessment of Michigan law leads us to conclude that the prevailing rule comports with Michigan insurance law and, therefore, to hold that a material misrepresentation by one insured permits rescission as to all insureds."

Finally, the court of appeals rejected the policyholder's arguments based on the purported "injustice" the innocent members of the insured firm would suffer as a result of the court's ruling. The court expressed its sympathy for the innocent members of the firm and stated that "even under the stricter rule, some courts, faced with a 'clear severability provision,' have denied rescission as to innocent insureds." In the instant case, however, the "[t]he [insured firm] admit[ed] . . . that this policy contain[s] no express severability clause" and attempted to rely instead on policy provisions relating to coverage issues to establish severability. The court held that such provisions "do not bring this policy within the ambit of the exception" and permitted rescission of the policy in its entirety.