

Rescission Appropriate Despite Lack of Intentional Misrepresentation

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The United States District Court for the Eastern District of Virginia, applying Virginia law, has held that an insurer could rescind a legal malpractice policy as to all insureds based on a material misrepresentation on the policy's application regardless of whether the individual insured providing the information was aware that the information was false at the time the application was submitted. *Minnesota Lawyers Mutual Ins. Co. v. Hancock*, 2009 WL 563900 (E.D. Va. Mar. 3, 2009).

The policyholder merged his solo law practice with that of another attorney. Unbeknownst to the policyholder, the other attorney embezzled client funds before the merger and continued to do so afterwards. That new attorney eventually reported the embezzlement to the state bar voluntarily. Subsequently, former clients of the firm sued to recover the embezzled funds, and the insurer instituted a declaratory judgment action against its insureds and the underlying claimants seeking to rescind the policy.

The insurer argued that it was entitled to rescind the policy based on material misrepresentations made in the policy application. At the time of the merger, the policyholder and the new attorney executed an "Adding an Attorney" form that represented that the new attorney was "[un]aware of any incident which could reasonably result in a claim being made against him." When the policyholder subsequently renewed the policy, he certified that the information in the prior "Adding an Attorney" form remained accurate and that "no 'firm member [was] aware of any INCIDENT which could reasonably result in a claim being made against the firm or a member of the firm.'" Finally, just prior to issuance of the renewed policy, the policyholder again represented there was no significant change to the information previously supplied to the insurer. After renewal, the new attorney disclosed the embezzlement. All parties to the litigation agreed that the original policyholder was unaware of the embezzlement prior to that disclosure.

In assessing the insurer's motion for summary judgment with respect to its rescission claim, the court noted that, under Virginia law, "[t]o rescind an insurance policy because of an insured's misrepresentation, an insurer ordinarily must 'show, by clear proof, two facts: (1) that the statement on the application was untrue; and (2) that the insurance company's reliance on the false statement was material to the company's decision to undertake the risk and issue the policy.'"

In assessing the first prong, the court first considered the defendants' argument that, because the policyholder was unaware of the embezzlement, the insurer could not show that he had made a knowingly false statement. The court stated that "nothing in the language of the [policy] . . . permitted [any of the insureds] to qualify their statements [to the insurer] contained in the [a]pplication." According to the court, irrespective of whether the policyholder knew of the new attorney's misrepresentation, he nonetheless adopted it and affirmed to the insurer that the information provided was accurate. Given that the new attorney indisputably was aware of the embezzlement, both his statement that he was unaware of any incident that could give rise to a claim against him and the policyholder's subsequent reaffirmance of that statement were untrue. Accordingly, the court found that untrue statements were made on the application.

With respect to materiality, while the court noted that the mere fact that the application asserted that the requested information was material was insufficient to establish materiality as a matter of law, the court nonetheless determined that the misstatement was material, noting that "common sense . . . suggests that the insurance company would either significantly limit or decline to provide insurance coverage . . . under these circumstances." Further, the court emphasized that the insurer had presented affidavits that indicated that the requested information was material and that the defendants had offered no evidence to the contrary. The court therefore determined that the misrepresentation was material.

The court next addressed the defendants' argument that the policy contained an "Innocent Insured" provision that applied to certain policy exclusions. It provided that such exclusions did not apply to insureds who were unaware of the subject misconduct. The court stated that the provision did "not reference or preclude the remedy of rescission for a material misrepresentation" and therefore rejected the argument.

Accordingly, having concluded that the requirements for rescission were satisfied and that the defendants' other arguments were without basis, the court entered summary judgment in favor of the insurer and held that the policy was "rescinded in its totality."