

Policy Rescinded after Insured Fails To Disclose Ongoing Disciplinary Proceedings in Application

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The United States District Court for the Eastern District of Kentucky granted summary judgment to an insurer, thereby rescinding a lawyers professional liability insurance policy, based on an insured's material misrepresentations in his renewal application regarding ongoing disciplinary proceedings. *Cont. Cas. Co. v. Law Offices of Melbourne Mills, Jr., PLLC*, 2010 WL 996472 (E.D. Ky. Mar. 15, 2009). Wiley Rein LLP represented the insurer.

The insured attorney, along with co-counsel, represented a group of over 400 plaintiffs who sought damages related to their injuries from the diet drug Fen-Phen. Plaintiffs' counsel settled the Fen-Phen action for \$200 million, but only distributed \$74 million of that amount to their clients. The attorneys paid the remainder to themselves and consultants as fees, and to set up a nonprofit organization.

In early February 2002, the insured became aware that the Kentucky Bar Association (KBA) was investigating his actions in connection with the Fen-Phen action. Specifically, on or around February 4, 2002, he was notified that a bar complaint was filed against him, and on February 11, 2002, his counsel attended a hearing of the KBA's Inquiry Commission relating to the bar's application to subpoena Fen-Phen settlement documents and related information.

On August 21, 2003, the insured submitted an application to renew his firm's professional liability insurance. Despite his knowledge of the KBA's investigation, the insured responded "no" to the application question that asked: "Has any attorney been disbarred, suspended, formally reprimanded or subject to any disciplinary inquiry, complaint or proceeding for any reason other than non-payment of dues during the expiring policy period?" The insured also referenced and attached a "Schedule 3," which stated:

During the current year no attorney has been disbarred, suspended, formally reprimanded or subject to any disciplinary inquiry, complaint or proceeding. In prior years, attorneys in the Firm have responded to inquiries filed by all jurisdictions exercising jurisdiction and control over attorney conduct. There have been no adverse findings regarding any attorney or other party's conduct.

The plaintiffs in the Fen-Phen subsequently sued the insured and others for malpractice. The carrier provided the insured with a defense in connection with the malpractice action under a reservation of rights, and filed a coverage action seeking, among other relief, rescission of the policy.

The court determined that the insured's application response regarding disciplinary proceedings was "clearly a misrepresentation or omission," given that he knew that a bar complaint had been filed against him in early 2002, and that the KBA's investigation was ongoing. The court determined that "the initial filing of a citizen complaint begins the process and probably satisfies the plain and reasonable definition of being subject to 'disciplinary proceedings.'" It added that "the fact that there was an ongoing KBA inquiry into [the insured's] actions with respect to the Fen-Phen Action is precisely the type of information [the carrier] needed to evaluate its potential for current and future risk." Moreover, the court found that the misrepresentation was clearly material given the underwriter's testimony that a positive answer would have prompted an investigation, which in turn would have resulted in "one of several potential restrictive underwriting actions" to limit the insurer's exposure.

In addition to holding the policy void *ab initio* and declaring that the policy did not afford any coverage for the malpractice action, the court held that the insurer was entitled to reimbursement of all defense expenses it had advanced to the insured.