

Insured's Failure To Disclose Participation in Fraudulent Scheme Entitles Insurer To Rescind Initial Policy

April 2011

The United States District Court for the District of New Jersey, applying New Jersey law, granted an insurer's motion for summary judgment to rescind an insurance policy issued to a lawyer who was named in numerous lawsuits during the pendency of the policy and later pled guilty to having participated in a criminal conspiracy that included the actions for which he was sued civilly. *Cont'l Cas. Co. v. Natale*, Civ. N o. 09-01961 (WHW) (D.N .J. Mar. 28, 2011). The court found that questions of fact precluded summary judgment regarding rescission of a subsequent policy or the application of the second policy's dishonesty exclusion to a demand letter tendered under that policy. Wiley Rein LLP represented the insurer in this matter.

In his application for the initial lawyers' professional liability policy, the insured represented that he was not aware of any act or omission that might reasonably be expected to be the basis of a claim against him. During the term of the policy, the insured was named in several civil lawsuits alleging that he participated in a fraudulent scheme in which the defendants purported to use investor funds to purchase, renovate and resell properties for a profit. The insured allegedly acted as a closing agent for certain of the properties and diverted investor funds to himself and other defendants. The insurer provided the insured with a defense in the lawsuits subject to a reservation of rights.

While the civil lawsuits were pending, the insurer issued a renewal policy to the insured. During the term of that policy, the insured tendered for coverage a demand letter from an individual containing allegations similar to those at issue in the civil lawsuits.

The insured later pled guilty to federal conspiracy and fraud charges in connection with the scheme alleged in the civil lawsuits. In his plea, the insured admitted to participating in the conspiracy beginning more than two years before the inception date of the initial policy. The insurer filed an action to rescind both policies and for a ruling that the dishonesty exclusion barred coverage for the demand letter.

The court granted the insurer's motion for summary judgment to rescind the initial policy because the insured did not disclose in the application for that policy his participation in the fraudulent scheme. The insured did not dispute that his statements in the application were untruthful or that disclosure of his participation in the

scheme would have been material to the risk. The court also concluded that it was reasonable for the insurer to rely on the insured's statements in the application because the policy specifically states that the insurer would do so, and there was no evidence that the insurer was aware of or should have been aware of the insured's criminal activity at that time.

However, the court denied the insurer's motion for summary judgment to rescind the renewal policy. The court found that there were issues of fact as to whether the insurer's reliance on the insured's statements in the renewal application was reasonable in light of its knowledge of the civil lawsuits filed during the initial policy period.

The court also denied the insurer's motion for summary judgment that the dishonesty exclusion barred coverage for the demand letter tendered under the renewal policy. The dishonesty exclusion applies to claims arising out of the insured's dishonest, fraudulent or criminal acts or omissions if such acts or omissions are determined by a court ruling or legal admission. The court reasoned that, although the allegations in the demand letter sounded similar to those in the civil lawsuits and the insured's guilty plea, the demand letter did not reference the entity or other individuals involved in the scheme. In addition, the court noted that the dates of the insured's admitted involvement in the criminal scheme had very little overlap with the dates at issue in the demand letter. Accordingly, the court concluded that a question of fact existed as to whether the insured's guilty plea could be considered a legal admission that the acts alleged in the demand letter were fraudulent.