

Lawyer's Policy Voided Based on Misrepresentation in Application, and Disbarment Order Triggers Dishonesty Exclusion

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The United States Court of Appeals for the Sixth Circuit, applying Kentucky law, has held that an insured attorney's failure to disclose circumstances surrounding excessive fees paid out of a class action settlement, which ultimately led to his court-ordered disbarment and related state bar association investigation justified rescission of the attorney's professional liability policy. *Cont'l Cas. Co. v. Law Offices of Melbourne Mills, Jr.*, 2012 WL 1232599 (6th Cir. Apr. 13, 2012). The court also held that, by virtue of the disbarment order, the policy's dishonesty exclusion barred coverage for the ensuing malpractice action filed against the attorney. Wiley Rein LLP represented the insurer in the case.

The attorney, along with other attorneys, represented over 400 plaintiffs in a class action lawsuit arising out of injuries stemming from the diet drug Fen-Phen. The parties settled the case for \$200 million, but the plaintiffs, who were not informed of the details of the settlement, received only \$74 million, or 37% of the settlement, in violation of their contingency fee contracts. The remainder of the settlement was split between several attorneys, including the insured and an affiliated foundation, of which the insured was a paid board member. After the settlement, the insured attorney learned that the state bar association was investigating complaints filed against him in connection with the Fen-Phen action. In his professional liability renewal application, however, the attorney answered "No" to the question whether there were "any claims, or acts or omissions that may reasonably be expected to be a claim against the firm."

The Fen-Phen plaintiffs ultimately filed a malpractice action against the attorney and others. The insurer provided the attorney with a defense under a reservation of rights and filed suit seeking a judicial declaration that it was entitled to rescind the policy based on material misrepresentations in the policy application. The claimants in the underlying action were awarded \$42 million, and the attorney was disbarred by court order for his conduct in connection with the Fen-Phen settlement.

The Sixth Circuit, affirming the trial court, held that the insurer was entitled to summary judgment on two independent grounds. First, the court held that the policy was void because the attorney made a material misrepresentation in the policy application. The court explained that, at the time of the application, the attorney knew not only of the ongoing bar association investigation, but also of his own conduct in connection with the Fen-Phen settlement that ultimately led to his disbarment. Relying on the enormity of the \$200 million settlement and the underwriter's testimony, the court concluded that the misrepresentations were material because the insurer would likely not have issued the policy, or would have issued a policy with different terms, but for the misrepresentation.

Second, the court held that coverage for the malpractice action was independently barred by the policy's dishonesty exclusion, which provided that the policy did not apply "to any claim based on or arising out of any dishonest, fraudulent, or criminal or malicious act or omission by an Insured," but that the insurer would provide a defense "unless or until the dishonest, fraudulent, criminal or malicious act or omission has been determined by any trial verdict, court ruling, regulatory ruling or legal admission, whether appealed or not." The court reasoned that the requirement for a court ruling was satisfied by the disbarment order, which confirmed that the attorney personally misappropriated funds and failed to exercise professional judgment over his co-counsel.