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NEWSLETTER

Material Misrepresentation Renders Policy Voidable, not Void *Ab Initio*

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An Illinois appellate court has held that a material misrepresentation by an insured in an application for insurance renders the resulting policy voidable, but not void *ab initio*, meaning that an insurer can waive its right to rescind the policy. *Ill. State Bar Assoc. Mut. Ins. Co. v. Coregis Ins. Co.*, 2004 WL 2913754 (Ill. App. Ct. Dec. 16, 2004). Under the facts of the case, however, the court held that the insurer did not waive its right to rescind the legal malpractice policy at issue by initially defending under a reservation of rights and waiting 15 months to rescind the policy.

On February 22, 1995, the Illinois Attorney Registration and Disciplinary Commission ("ARDC") filed a complaint against the insured attorney alleging conversion of client funds. The attorney admitted that he had converted the funds in question in an answer filed with the ARDC on May 4, 1995. In October 1995, the attorney applied for a renewal of the legal malpractice policy and responded 'no' to the question of whether he was aware of any "circumstance, act, error, omission or personal injury which may result in a claim" against him.

On January 20, 1996, the attorney was sued by the former client for conversion, legal malpractice, breach of fiduciary duty, and breach of contract. In August 1996, the attorney was suspended from practice. After learning of the disbarment in September 1996, the insurer refused to renew the attorney's policy, but did not rescind the attorney's existing policy. Three weeks later, the attorney tendered the client lawsuit to the insurer, which responded by notifying the attorney by letter that it would defend him. In that letter, the insurer included a reservation of rights and also highlighted several exclusions that might apply to bar coverage, although it did not specifically mention rescission. In August 1997, the insurer filed a complaint against the attorney and the attorney's former client seeking a declaratory judgment that it owed no duty to defend or indemnify the attorney against the former client's suit. The complaint did not state a claim for rescission. Five months later, in January 1998, the insurer sought leave to amend its declaratory judgment complaint to state a claim for rescission.

The court considered as a matter of first impression whether an insured's material misrepresentations render a policy voidable or, alternatively, void *ab initio*, under Illinois law. The court initially noted that an insurer cannot, as a legal matter, waive its right to rescind a policy if that policy is held to be void *ab initio*. The court concluded that policies secured by insureds via material misrepresentations are rendered merely voidable,

and an insurer's right to rescind such policies may therefore be waived. In reaching this conclusion, the court relied upon *Golden Rule Insurance Co. v. Schwartz*, 786 N.E.2d 1010 (Ill. 2003). In that case, the Illinois Supreme Court interpreted Illinois Insurance Code Section 154, setting forth the criteria for rescission on grounds of misrepresentation. The *Golden Rule* court referred to Section 154 as "establish[ing] a two-prong test to be used in situations where insurance policies may be voided." Based on the *Golden Rule* court's use of the words "*may be voided*," the *Coregis* court concluded that policies secured via misrepresentations are voidable, but not void *ab initio*.

The court also held that the standard for whether an insurer waives its right to rescind a voidable policy is the same as the standard for determining whether an insurer waived a policy defense: the right of rescission is deemed waived where the insurer's words or conduct are inconsistent with its intention to rescind. The court held that the insurer had not waived its right to rescind the attorney's policy by initially defending the lawsuit since it did so pursuant to a reservation of rights letter. Although the letter did not specifically mention "rescission," the court noted that it highlighted various provisions of the policy, including one allowing a claim to be denied based on prior knowledge. More importantly, the court explained that the letter generally stated that the company "does not waive any rights or defenses it may have available nor does it waive its right to deny coverage at a later date."

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