

Insurer Allowed to Rescind Policy Based on Attorney's Material Misrepresentations in Application

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In an unpublished opinion, the United States Court of Appeals for the Fourth Circuit, applying Virginia law, has held in a ruling on summary judgment that a professional liability insurer could rescind a legal malpractice policy issued to a law firm because the law firm made material misrepresentations in its renewal application. *TIG Ins. Co. v. Robertson, Cecil, King & Pruitt*, 2004 WL 2603660 (4th Cir. Nov. 17, 2004).

The insurer issued a legal malpractice policy to a law firm. The initial application for insurance asked the policyholder whether "any attorney in your firm [was] aware of any claims made (whether reported or unreported), wrongful acts, errors, or omissions that could result in a professional liability claim against any past or present attorney of the firm or its predecessors or ...[whether] there [was] a reasonable basis to foresee that a claim would be made against any past or present attorney or the firm or its predecessors." The policyholder answered "no" on both its initial application and its renewal application.

After the policy was renewed, the law firm discovered that the attorney who completed the application, since deceased, had misappropriated client funds before signing the application. The attorney did not disclose this information on the application. Thereafter, several clients of the law firm filed suit. Upon tender, the insurer filed the current action to rescind the policy based on material misrepresentations in the renewal application. Alternatively, the insurer argued that the clients' lawsuits were excluded by the policy. The law firm, its partners and the estate of the attorney who completed the renewal application counterclaimed for breach of contract.

The Fourth Circuit affirmed the insurer's right to rescind the policy based on material misrepresentations made in the renewal application. The court explained that Virginia law allows rescission if the insurer "can show 'by clear proof' that (1) a statement in the application was untrue, and (2) 'the insurance company's reliance on the false statement was material to the company's decision to undertake the risk and issue the policy.'" On the first element, the court rejected the law firm's argument that the statements were accurate because the firm was not notified of any client dissatisfaction when it signed the application. The court explained that "[c]lient notification ...is not required under the plain language of the policy which requests information on 'any claims ...wrongful acts, errors or omissions that *could* result in a professional liability claim.'" The court also rejected the argument that the statements were accurate because the offending lawyer could have "converted the

fund" before he died. Instead, the court found that the attorney converted the funds before he completed the application, thereby rendering the statements "patently untrue." Turning to the second element required for rescission, the court held that, based on testimony by the underwriter, the misstatements were material because "the underwriter's sworn statements, particularly when uncontradicted, are sufficient to demonstrate the materiality of misrepresentation."

The court then rejected the policyholder's argument that the insurer waived the right to rescind because the terms of the policy allowed the insurer to cancel the policy if material misrepresentations are discovered. The court explained that rescission and cancellation are separate remedies—rescission allows an insurer to deny all claims, while cancellation only applies to claims arising after the policy is cancelled. The policy gave the insurer the right to choose from the remedies. "Although an insured could contract for 'greater protection,' including a limitation of remedies, the [policyholder] did not do so here."

Finally, the court rejected the argument that the innocent partners provision in the policy restored coverage for the lawsuits. The policy provided coverage to innocent partners for "judgments 'arising out of any dishonest, fraudulent, criminal, malicious or knowingly wrongful act, error, or omission or Personal Injury.'" However, the court explained that this protection did not extend to material misrepresentations made in an application form. "Thus, although [two of the partners] may, in fact, be 'innocent,' they did not contract to be protected in this circumstance, and as a result, rescission of the policy does not violate the 'clear intent of the policy.'"

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