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ALERT

Insurer Entitled to Rescind Lawyers Malpractice Policy Based on Material Misrepresentations in Application

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The United States District Court for the Middle District of Florida, applying Florida law, has held that a lawyers malpractice policy was void *ab initio* based on material misrepresentations made by the insured in the application for the policy. *Darwin Nat'l Assur. Co. v. Brinson & Brinson*, 2013 WL 2406154 (M.D. Fla. June 3, 2013). The court also held that the insurer did not waive its right to rescind the policy by agreeing to provide a defense because the insured was not prejudiced by the insurer's defense of the underlying action.

The insured, a law firm, was retained to represent a limited liability company and its manager in a foreclosure action. Before the insured was retained to represent the company and its manager, a default judgment was entered against the company. Four months after the firm's retention and five days before trial in the foreclosure action, the firm filed a motion to set aside the default judgment, which was denied. After trial, a $2.85 million judgment was entered against the company, and the firm filed a notice of appeal.

The appellate court issued an order to show cause why the company's appeal was not premature, and the firm's attorneys failed to respond. The court sanctioned the attorneys and issued an additional order to show cause why the court should not refer the matter to the Florida Bar. When the attorneys did not respond, the appellate court issued an order referring the attorneys to the Florida Bar for investigation and discipline. The appellate court issued an additional show cause order after the attorneys failed to file the initial brief by the required date.

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After these events, the firm submitted an application for a lawyers malpractice policy, which requested that the firm respond based on its "knowledge and belief." The firm did not disclose the appellate court's order referring the firm's lawyer to the Florida Bar or an unrelated bar complaint in response to a question asking whether "any attorney [had] been the subject of any bar complaint, investigation or disciplinary proceeding within the past ten years." The firm also responded that it was not "aware of any claims against the law firm or its attorneys, or any incidents that could result in a claim against the law firm or its attorneys."

Based on the application, the insurer issued a policy to the firm. After the policy's inception, the company's malpractice lawyer sent a letter to the firm and provided notice of a malpractice claim related to the foreclosure action and appeal. The insurer initially retained counsel to defend the malpractice action and required the insured to satisfy the policy's retention. Two months later, the insurer denied coverage for the malpractice claim based on material misrepresentations in the application for the policy and filed a declaratory judgment action seeking to rescind the policy.

The court held that the firm made representations on the application that it knew were false. First, the insured failed to report the referral by the appellate court to the Florida Bar and an unrelated bar complaint filed by another client despite having knowledge of both bar complaints. Second, the court held that the insured failed to disclose the facts surrounding the foreclosure action and appeal when responding to the application question requesting incidents that could result in a claim. The court held that the firm "clearly knew of numerous incidents relating to the representation" of the company in the foreclosure action and appeal that "could result in a claim" against the firm or its attorneys. Namely, the firm and its attorneys knew that they failed to file a motion to set aside the judgment until five days before trial; the motion had been denied and resulted in a $2.85 million judgment against the company; firm attorneys failed to respond to multiple show cause orders and had been sanctioned by the appellate court and the appellate court had referred firm attorneys to the Florida Bar.

The insurer offered an underwriter's testimony that the insurer would not have issued the policy if the information concerning the foreclosure action and the appeal had been disclosed on the application. The insured offered no evidence to rebut the underwriter's testimony. Based on the unrebutted evidence proffered by the insurer, the court held that the misrepresentations were material to the insurer's acceptance of the risk and, if the insurer had known of the undisclosed facts, the insurer would not have issued the policy.

The insured contended that the insurer was estopped from rescinding the policy because it agreed to provide a defense and required the insured to satisfy the retention before seeking to rescind the policy. The court rejected this argument. The court held that estoppel did not apply because the insured offered no evidence that it had been prejudiced by the insurer's defense of the malpractice claim. In fact, the insured benefitted from being provided a defense to which it was not entitled.