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NEWSLETTER

Coverage Not Barred Where Insured Law Firm Failed to Disclose Prior Representation Had Been Terminated

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The United States Court of Appeals for the Ninth Circuit, applying Arizona law, has reversed a district court's entry of summary judgment in favor of a professional liability insurer whose policyholder failed to list its inadequate representation of former clients as a potential claim on its policy application. *James River Ins. Co. v. Hebert Schenk, P.C.*, 519 F.3d 917 (9th Cir. 2008), *modified*, 2008 WL 1836729 (9th Cir. Apr. 25, 2008). In doing so, the court determined that a reasonable person could disagree over whether the application sought the policyholder's subjective opinion or a factual response and that it was unclear whether the malpractice claim that did result was reasonably foreseeable.

In the underlying matter, the policyholder law firm was retained by a couple seeking representation following a business failure. An attorney for the firm met with the clients and promised to perform certain follow-up actions on their behalf. However, he thereafter failed to respond to numerous phone calls or otherwise communicate with the clients for nearly three months after this meeting. The clients finally sent a letter to the attorney chastising him for his inattention and indicating that they wished to terminate their relationship. To "bring the matter to a close," the clients demanded the return of their documents and a waiver of their legal fees. In a response letter, the attorney "acknowledg[ed] his fault and stat[ed] that [the clients'] complaint was" correct in every aspect." He also agreed to return the documents and waive the fees.

One week before receiving the former clients' termination letter, the firm had applied for a professional liability policy. The application inquired whether any lawyers within the firm were "aware of any circumstances, allegations . . . or contentions as to any incident which may result in a claim being made" against the firm, and required the attorneys to identify any such potential claims. The firm did not disclose any information regarding a potential claim by the couple. Approximately two weeks after receiving the letter, the insurer issued the firm a quote and advised the firm that before it would issue the policy, the firm would need to update its application and supplement signatures. The firm did so, advising that it "ha[d] no known claims and no known claims incidents" to report at that time. The insurer thereafter issued the policy.

The former clients subsequently filed malpractice claims against the firm, to which the firm demanded the

insurer provide a defense. The insurer did so under a reservation of rights and also filed a declaratory judgment action, arguing that the policy did not cover the claims because they were reasonably foreseeable and were not disclosed prior to policy issuance.

On appeal, the court first addressed whether the firm's failure to mention the prospect of a claim after receiving the termination letter constituted a fraudulent misrepresentation. Both parties agreed that the firm did not engage in actual fraud because the firm had no intent to deceive; they disagreed, however, over whether its actions amounted to legal fraud, which, under Arizona law, can only occur when a policyholder provides a false answer in response to a question that seeks facts within the policyholder's personal knowledge. The firm argued that it did not commit such fraud because the question asking about potential claims sought an opinion rather than a factual response.

The appellate court agreed with the firm, determining that reasonable persons could differ about whether the question sought a statement of opinion or fact. The court determined that, although "awareness of circumstances" is a "factual condition," whether the firm was aware of circumstances that "may result in a claim being made" against the firm is "fairly viewed as a matter of opinion" and a "judgment call reflecting an analysis of those circumstances." Thus, the court determined that reasonable people could conclude that the firm's failure to mention the communications with its former clients simply reflected its opinion that a claim would not result. In doing so, the court rejected the insurer's argument that the application responses should have been judged by an objective standard. The court noted that the insurer's question did not specify whether an applicant's assessment about potential claims should be based on its subjective assessment or an objective, reasonable person standard. The court further indicated that, even if the question clearly called for an objective standard, answering the question required the policyholder "to exercise judgment in applying that standard to the facts concerning particular clients" and thus its response was not clearly unreasonable.

The court also rejected the insurer's argument that coverage was precluded based on policy language excluding claims arising from legal services rendered prior to the policy's effective date if the policyholder "knew or could have reasonably foreseen" that the service "could give rise to a 'claim.'" The court held that summary judgment was unwarranted because it was not clear that the claim was reasonably foreseeable, as nothing in the letter sent by the policyholder's former clients demanded or threatened a future demand for money damages or other legal remedies. Instead, it noted, the former clients stated that the matter could be brought to a close if their documents were returned and their fees waived, requests with which the firm complied. Viewing the evidence in a light most favorable to the firm, the court held that the firm could reasonably have concluded that a claim would not result.