

Policy Issued to Law Firm Void as to Two Partners Engaged in Conduct Not Disclosed in Application and as to the Firm, But Not as to “Innocent” Partner

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The New Jersey Supreme Court has held that an insurer that had issued a legal malpractice policy to a three-person law firm was entitled to rescind coverage as to the managing partner who had engaged in conduct not disclosed in the application he signed, as to a second partner engaged in the same conduct and to the firm as an entity, but that the insurer could not rescind coverage as to the lone partner without knowledge of the falsity of the representations. *First Am. Title Ins. Co. v. Lawson*, 2003 WL 21666583 (N.J. July 17, 2003). The court based its decision on various public policy considerations and did not identify the existence of a severability clause.

In obtaining legal malpractice coverage for the three-person law firm, the managing partner signed a warranty statement that he was "not aware of any circumstances or any allegations of contentions as to any incident, which may result in a claim being made against the firm or any of its...partners." In fact, the partner knew those statements were false because he was engaged in the unauthorized practice of law by acting as a closing attorney in a state where he was not authorized to do so and, in concert with a second partner, by misappropriating client funds. The insurer sued to rescind the policy.

The court held that the insurer had "the clear right to rescind the [managing partner's] coverage in the face of his blatant and direct misrepresentations." It also held the insurer could rescind coverage as to the second partner, who was involved in misappropriating client funds because he "knew or should have known that the forms submitted to the carrier contained false or misleading information."

The court also held that the carrier could rescind the policy as to the firm as an entity. The court reasoned that "[p]ermitting the firm's coverage to survive [the managing partner's] defalcations would, in essence, condone the use of a partnership entity as a subterfuge for fraudulent conduct." In so holding, the court emphasized the role of the managing partner in the misrepresentations and noted that "[t]his is not a case in which a lone attorney in a multi-person firm knowingly had supplied the managing partner with false information that the partner merely forwarded to the carrier without knowledge of its falsity."

The court held, however, that the carrier could not rescind coverage as to the third partner. The court noted that the third partner did not engage in the relevant conduct, had no knowledge of the conduct and, in fact, generally worked out of a separate office. The court therefore characterized him as an "innocent" partner. The court also reasoned that if coverage were denied as to that attorney, he would have no coverage for unrelated acts of malpractice that might have occurred and that result "could leave members of the public, whom [that partner] represented throughout that period, unprotected even though the insured himself committed no fraud. In our view, that harsh and sweeping result would be contrary to the public interest." In particular, the court noted that denying coverage to that attorney would be inconsistent with the requirement in the Rules of Court that attorneys maintain malpractice insurance.

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