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NEWSLETTER

# Insurer Entitled to Rescind E&O Policy Based on Insured's Failure to Disclose Prior Claims

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The United States District Court for the Eastern District of Pennsylvania, applying Pennsylvania law, has held that an insurer was entitled to rescind an errors and omissions policy where the insured title insurance agency failed to disclose prior claims against it. *Whitford Land Transfer Co. v. Seneca Ins. Co.*, 2008 WL 4792386 (E.D. Pa. Oct. 31, 2008). In doing so, the court rejected the insured's argument that it was required to disclose only claims that it believed might create exposure for the insurer.

Beginning in 2005, the insurer issued three consecutive annual errors and omissions policies to the insured title insurance agency. The initial application and the two subsequent renewal applications asked whether "claims had been made" against the applicant within the last five years and whether the applicant was aware of any "act, error, or omission which might reasonably be expected to give rise to a claim" in the future. The title insurance agency's president completed the applications and answered "no" to both questions on the initial 2005 policy application and on the 2006 renewal policy application. However, during the term of the 2005 policy, a claim was made against the insured title insurance agency and, prior to applying for the 2006 policy, the title insurance agency gave notice of that claim to the E&O insurer. The title insurance agency, however, did not disclose the pending claim in its 2006 policy application. The E&O insurer's underwriting department learned of the claim from the E&O insurer's claims department and charged a higher renewal premium because of the claim.

The E&O insurer regarded the title insurance agency's failure to disclose the 2005 claim on its 2006 application a "suspicious circumstance" and conducted additional investigation when its policy came up for renewal in 2007. That investigation revealed two prior claims that the title insurance agency did not disclose in any of its three applications. Nonetheless, due to non-renewal notification requirements, the E&O insurer was required to renew the policy but charged the maximum premium and reduced coverage. Subsequently, the E&O insurer discovered several additional lawsuits against the title insurance agency that the title insurance agency had not disclosed on any of its prior applications.

The insured subsequently instituted a declaratory judgment action to establish whether the 2005 claim was subject to coverage. In response, the insurer filed a counterclaim for rescission, arguing that the insured's failure to disclose the prior claims constituted a material misrepresentation. The title insurance agency

countered that the term "claim" was ambiguous and that a reasonable person could construe the term to refer only to claims that could create exposure for the E&O insurer. In support of this argument, the insured pointed to the fact that it did not seek coverage for any of the non-disclosed claims and that three of the non-disclosed claims were settled or otherwise resolved before it submitted its first application. Based on these facts, the title insurance agency argued that its president reasonably considered that these claims were not relevant for purposes of the applications.

The court rejected the insured's argument, citing a series of cases holding that the term "claim" is not ambiguous, even where it is not defined. The court further determined that a reasonable person would not interpret the term "claim" to refer only to claims that could create exposure to the E&O insurer. The court also referred to the title insurance agency's president's deposition testimony, in which he stated that the term "claim" "has to do with . . . an action where someone has the potential to have you pay something to them." The court pointed out that each of the non-disclosed claims fit "the dictionary definition of 'claim,' *i.e.*, 'a demand for money'" and also fit the title insurance agency's president's understanding of the term.

The insured also argued that the E&O insurer was not entitled to rescind because the title insurance agency had not made any misrepresentations knowingly or in bad faith. The court, however, pointed out that an insurer need only show that an applicant knew that statements in an application were false when made; Pennsylvania law did not require that the false statements be made with intent to deceive. The court determined that the title insurance agency "knowingly made misrepresentations" on its applications because the question regarding prior claims was unambiguous and the insured had not disclosed the prior claims.

The title insurance agency also challenged whether any of the misrepresentations were material. In support of this argument, the insured emphasized that the E&O insurer twice renewed coverage even after being notified of the 2005 claim, which could have created exposure well in excess of the amounts in all of the previous non-disclosed claims combined. The court rejected this argument, explaining that the title insurance agency's "notion of materiality" was "much narrower than that of courts applying Pennsylvania law, which generally consider a statement to be 'material' where it is relevant to the risk assumed." The court cited the fact that the E&O insurer raised the premium for the 2006 policy after learning of the 2005 claim and, for the 2007 policy, raised the premium further and reduced coverage. The court then stated that "the undisclosed lawsuits . . . all of which involved allegations of wrongful conduct by [the title insurance agency] in rendering professional services . . . would have undoubtedly been relevant to the risk assumed." The court thus determined that the title insurance agency's misrepresentations "were clearly material."