

Rescission Action Barred by Statute of Limitations

December 2009

The United States District Court for the Southern District of New York, applying New York law, held that an action for rescission brought by professional liability insurers was barred by the applicable statute of limitations. *Certain Underwriters at Lloyd's, v. Milberg LLP*, No. 08 Civ. 7522 (S.D.N.Y. Sept. 30, 2009). In so holding, the court rejected the insurers' contentions that the insureds were equitably estopped from asserting a statute of limitations defense and that the limitation period was tolled by a reservation of rights.

The insurers issued professional liability policies to the law firm in 2001. In 1998, during the application process for a preceding policy, the insureds declared that no attorney at the firm was aware of "any circumstances . . . which may result in a claim being made against" the firm. In 2002, a government investigation of the insureds commenced. Shortly thereafter, the insureds informed the insurers of the investigation and assured the insurers that the allegations were baseless. Subject to a reservation of rights, the insurers agreed to fund the insureds' defense. In May 2006, the insured firm was indicted for its role in an alleged kickback scheme. The insureds provided the insurers with a copy of the indictment in July 2006. In July 2008, the last of several attorneys at the insured firm pled guilty to the charges. Shortly thereafter, in August 2008, the insurers filed an action seeking rescission of the policy based upon misrepresentations made during the application process. The insureds filed a motion to dismiss on the basis that the insurers' action was barred by New York's six-year statute of limitations.

The court dismissed the insurers' claims for rescission as untimely pursuant to the statute of limitations. First, the court rejected the insurers' contention that the insureds were equitably estopped from raising a statute of limitations defense. According to the insurers, the doctrine of equitable estoppel precluded the defense because the insurers had reasonably relied upon repeated assurances that the allegations against the insureds were baseless. The court determined that "mere denials of wrongdoing . . . are insufficient to justify estoppel," and the insurers failed to prove that their reliance on the insureds' representations was reasonable. According to the court, the insurers' reliance on the insureds' statements was unjustified because the present situation "involves a contractual relationship between an insurer and an insured, both of whom are sophisticated parties dealing at arm's length."

Second, the court rejected the insurers' argument that the statute of limitations was inapplicable. The insurers argued that the statute did not apply because the policy was void upon inception. The court rejected this argument and noted that the six-year statute of limitations period applied to cases alleging fraud. Likewise, the court rejected the notion that the reservation of rights had tolled the limitations period. According to the court, the insurers presented "no authority holding that an insurer's defense of its insured is inconsistent with its investigating the validity of its contractual duty to defend."

Finally, the court held that the insurers' rescission claim was not saved by New York's "discovery rule," which provides a two-year window to bring a fraud claim from the time the fraud was either discovered or would have been discovered through the exercise of reasonable diligence. The court held that the insurers were on notice of the alleged fraud in 2002, when the insured notified them of the government investigation. Moreover, the court noted that "the most striking example of [the insurers'] willful ignorance of their potential rescission claim [was] their failure to have made any inquiry after [the insureds were] indicted" in 2006.