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NEWSLETTER

Insurer Allowed to Rescind Policy Based on Attorney's Material Misrepresentations in Application

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The U.S. District Court for the Eastern District of Virginia, applying Virginia law, has held in a ruling on summary judgment that a legal malpractice insurer could rescind a policy because the policyholder made material misrepresentations in its insurance application. *Cont'l Cas. Co. v. Graham & Schewe*, 2004 WL 2331684 (E.D. Va. Sept. 28, 2004).

The insurer issued a legal malpractice policy to a law firm. Before the law firm applied for the policy, one of its clients had filed for a writ of *habeas corpus* arguing that the law firm had provided ineffective assistance during his criminal trial, which resulted in a conviction. A Virginia court granted the writ of *habeas corpus* and the former client was then retried and acquitted of the charges.

Subsequently, the law firm applied for a legal malpractice policy. The application asked: "[a]fter inquiry is any attorney in the firm aware of...[a]n act or omission that may reasonably be expected to be the basis of a claim against them, the firm, any predecessor firm, or against any current or former attorney of the firm, while affiliated with the firm?" The law firm answered "no" and did not disclose the writ of *habeas corpus* for ineffective assistance of counsel. Based on the application, the insurer issued the policy. The policy stated that the insurer's obligation to pay under the policy was conditioned on "no insured [having] had a basis to believe that any such act or omission, or related act or omission, might reasonably be expected to be the basis of a claim" before the inception of the policy. Thereafter, the firm's former client filed a suit against the law firm for legal malpractice and breach of contract. The law firm tendered the claim to the insurer, which denied coverage.

The court granted the insurer's motion for summary judgment, holding that the insurer could rescind the policy because the law firm "had a basis to believe that [the former client] might reasonably be expected to assert claims of malpractice against them at the time they completed" the application. The court explained that Virginia law allows rescission if "(1) the statement on the application was untrue, and (2) the insurance company's reliance on the false statement was 'material to the company's decision to undertake the risk.'" The court found that, based on the writ of *habeas corpus* for ineffective assistance of counsel, the law firm was "aware of acts or omissions that could reasonably be expected to be the basis of a claim against them" when

it applied for insurance, but failed to disclose that fact. "Even if they believed that they would have prevailed on an ineffective assistance of counsel claim," the law firm was required to disclose these facts on the insurance application.

The court also found that the law firm's omissions on the application were material. The court explained that Virginia tests materiality by determining whether "'truthful answers would have reasonably influenced' the insurance company in making its decision to issue a policy." The director of underwriting for the insurance company filed an affidavit attesting to the materiality of the fact that a former client was granted a new trial based on ineffective assistance of counsel in deciding whether to issue a policy. The court found this evidence persuasive, and allowed the insurance company to rescind the policy.

For more information, please contact us at 202.719.7130.