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NEWSLETTER

Failure to Disclose Nonclient Claims on Professional Liability Application Justifies Rescission

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In an unpublished opinion, the United States Court of Appeals for the Fourth Circuit, applying Virginia law, has reversed summary judgment in favor of an insured, holding that the insured's failure to disclose more than 500 lawsuits filed against it constituted a material misrepresentation in its application for lawyers' professional liability insurance, permitting the insurer to rescind the policy at issue. *Carolina Cas. Ins. Co. v. Draper & Goldberg, P.L.L.C.*, 2005 WL 1601422 (4th Cir. July 8, 2005).

The insured law firm represented clients in foreclosure actions against debtors. The nonclient debtors routinely sued the law firm in its capacity as successor trustee in their attempts to block the foreclosures. Of the approximately 500 suits filed against it, the insured sought defense and indemnity from previous professional liability carriers for only five suits—all of which were brought by nonclients. When asked on the current application whether "any professional liability claim" was made against it, however, the insured disclosed only those five suits that it had submitted to previous carriers. Based on that response, the insurer issued the policy. Four months later, nonclients filed two class action lawsuits against the law firm, both of which alleged that it breached its fiduciary duty to the nonclient debtors and violated the Fair Debt Collections Act. The law firm tendered those lawsuits to the insurer for defense and, upon discovering the earlier undisclosed lawsuits, the insurer brought an action to rescind the policy. The district court subsequently granted summary judgment to the law firm, and the insurer appealed.

In reviewing the dispute, the Fourth Circuit explained that, under Virginia law, an insurer may rescind a policy based on a misrepresentation if (1) the insured's representation was false and (2) the insurer's reliance on that representation was material to its decision to issue the policy, citing Va. Code Ann. § 38.2-309 and *Commercial Underwriters Insurance Co. v. Hunt & Calderone, P.C.*, 540 S.E.2d 491, 493 (Va. 2001). With respect to the first element, the appellate court concluded that the phrase "professional liability claim" unambiguously included all claims seeking to assert liability against the law firm arising out of its practice of law, and thus, that the law firm's response on the application was false. In reaching that conclusion, the appellate court rejected the insured's theory that the phrase referred only to legal malpractice claims, observing that such an interpretation ignored the plain, unambiguous application language.

The appellate court next addressed the materiality of the misrepresentations. Noting that two representatives of the insurer testified that it would not have issued the policy had it known "of even a small fraction of the hundreds of foreclosure lawsuits" and that the sheer volume of claims rendered the law firm an unacceptable risk, the appellate court concluded that the law firm's omission was material because the insurer reasonably would have been influenced to reject the law firm's application had the insurer known the claim history when it issued the policy.

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