

Material Misrepresentations in Lawyers Professional Liability Policy Warrant Rescission

Carolina Casualty Ins. Co. v. Robert S. Forbes, P.C., et al.
2017 WL 86136 (S.D. IL Jan. 10, 2017)

Addressing important issues of timeliness and materiality, the U.S. District Court for the Southern District of Illinois recently rescinded a lawyers professional liability policy in light of the insured's misrepresentations in applying for the policy. In granting rescission, the court analyzed the application of Illinois' statutory one-year limitation period for rescission of certain insurance policies, the materiality requirement, and the waiver doctrine as it applies in rescission cases.

The insured law firm – a professional corporation – applied for the professional liability policy in April and May of 2014. The insured attorney represented in the application that he was not aware of any fact, circumstance or situation that might reasonably be expected to result in a professional liability claim or suit against the firm or him. At the time he signed the application, though, the attorney was aware that the Illinois Appellate Court previously ruled against his client in a workers compensation case. The appellate decision in favor of the client's employer resulted from the insured attorney's failure to timely file a document necessary to his client's claim.

The insured attorney also represented in the application that no attorney in the firm was the subject of any disciplinary proceeding within the preceding five years. But at that time, he was in the middle of proceedings in front of the state disciplinary commission stemming from allegations of professional misconduct beginning in 2006.

After the insurer issued the policy, the insured attorney's former client asserted a malpractice claim. And the client later filed a lawsuit alleging that the attorney's conduct in the handling of the workers compensation case resulted in the adverse decision against the client. In January 2015, the insurer acknowledged the claim and disclaimed coverage, reserving the right to seek rescission in the future. The insurer reconfirmed its disclaimer in June 2015, and again reserved the right to seek rescission at a later time.

The insurer filed a suit for rescission in January 2016, asserting that the attorney's statements regarding knowledge of a potential claim and disciplinary proceedings were misrepresentations permitting the policy's rescission. When the insurer moved for summary judgment, the attorney argued that rescission should not be granted because (1) an Illinois statute prevented rescission of a policy in effect for more than one year; (2) the misrepresentations were not material as a matter of law; and (3) the insurer waived any rights to rescind by delaying in seeking that remedy. The court rejected all three arguments.

By statute (215 ILCS 5/154), insurers in Illinois are not permitted to rescind certain types of policies after the policy is in effect for one year or one term, whichever is less. The statute applies to specific lines of coverage and includes a catch-all for "all other policies of personal lines". Illinois law defines "policies of personal lines" as policies

“issued to a natural person for personal or family protection.” 215 ILCS 5/143.13(c). But the policy involved in *Forbes* was issued to a professional corporation, not to a natural person. Therefore, the court refused to apply the statutory one-year/one-term limitation on rescission.

The court then addressed materiality. The insured asserted that the insurer’s evidence of materiality was insufficient because it did not show that the insurer would have refused to issue the policy had the insured disclosed his prior knowledge and involvement in disciplinary proceedings. The court rejected that approach, holding that a misrepresentation is material if it would have resulted in either a rejection of the application or an increased premium. In reaching its conclusion, the court was guided by the statutory standard of 215 ILCS 5/154, which applies to a misrepresentation that “affects either the acceptance of the risk or the hazard assumed” by the insurer. The court found that the true facts would have led the insurer to either refuse to issue the policy or issue it with an increased premium, and the misrepresentations were therefore material.

Finally, the court agreed with the insurer that it did not waive its right to seek rescission, despite a one-year time lag between the insurer’s claim acknowledgment and filing of a rescission action. Under Illinois law, waiver is defined as the voluntary relinquishment of a known right. The court recognized that a party seeking to rescind a policy should do so promptly after learning of the basis of the rescission, but conduct inconsistent with waiver during a delay can prevent waiver of

rescission rights. The court found that, while the insurer waited more than one year after learning of the underlying claim, it did nothing that would reasonably have led anyone to believe it was waiving its right to rescind. On the contrary, the insurer sent letters to the insured expressly reserving the insurer’s right to rescind the policy if it concluded that the insured had made material misrepresentations on the application. Under those circumstances, the court found it was not unreasonable to wait a year to seek rescission while investigating the matter and later discovering the ARDC proceedings. So the insurer did not voluntarily relinquish its right to rescind.

Comment

The *Forbes* case provides helpful guidance to insurers and insureds on all three of the principal issues addressed in the decision, i.e. (1) application of the Illinois one-year/one-term limitation on rescission of certain types of policies, (2) materiality of misrepresentations in the application, and (3) application of the waiver doctrine in the context of insurance policy rescission. Additionally, its discussion of the first and third issues reinforces the importance of timeliness and prompt investigation of possible misrepresentations in insurance applications.

If you have any questions about this Update, please contact the author listed below or the Aronberg Goldgehn attorney with whom you normally consult:

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