

New Jersey Appellate Division Upholds No Coverage Determination Based Upon Material Misrepresentation

May 3, 2018

On May 1, 2018, the Appellate Division of the Superior Court of New Jersey upheld a disclaimer of coverage under a lawyer's professional liability policy based upon a material misrepresentation in the law firm's insurance application. The decision, *Ironshore Indemnity, Inc., v. Pappas & Wolf LLC, et al.* (Docket No. 8-0959-16T1), confirms New Jersey's use of a subjective standard in determining whether the failure to disclose a potential claim in an insurance application rose to the level of a material misrepresentation and provides guidance on how courts apply that standard.

In *Ironshore*, a law firm had intimate knowledge of the business dealings of its client based upon its role as counsel to the company from 2006 to 2010. As a result, the firm was aware that its client was having solvency issues and potential legal issues pertaining to the operation of the company. In 2010, the New Jersey Attorney General sued the firm's client for securities-related fraud. Although neither the firm nor any attorneys at the firm were named as defendants, the partner in charge of the firm testified that he was concerned about claims against him, even though he did not expect any type of legal malpractice claim to be filed against him. Based upon his asserted, subjective belief that no legal malpractice claims would be filed, he did not disclose the existence of any potential claims when completing the insurance application in 2011.

The Court acknowledged that a subjective standard applies when reviewing an insured's representation regarding prior knowledge of a potential claim in response to an insurance application question. The Court recognized that because New Jersey utilizes a subjective standard, it is difficult to obtain summary judgment on this issue. Nevertheless, the Court pointed out that subjective intent may not always be controlling when the totality of undisputed facts suggests otherwise.

Accordingly, the Court held that the firm's negative response in the insurance application, in response to the question of whether it was aware of any act or error that may result in a professional liability claim against it, was a material misrepresentation and formed a proper basis for the malpractice insurer's denial of the claim. Irrespective of the attorney's testimony that he was not concerned about a legal malpractice claim against the firm, his testimony that he was concerned about "a claim" sufficed to form the basis of a material misrepresentation. The Court did not believe that the attorney's distinction between a "claim" and "legal malpractice claim" was persuasive. Ultimately, the Court held that when looking at the totality of the circumstances it was hard to believe that the firm felt immune to legal malpractice claims, having provided securities-related advice to a client for the nearly two-and-a-half year period before the client was sued for securities fraud.

Although the Appellate Division's decision does not create new law, it is important because, in granting summary judgment to the insurer, the Court did not take an attorney's testimony that he did not expect a legal malpractice case claim to ensue at face value. Rather, the Court delved into the facts of the claim, reviewed the totality of the circumstances and concluded that the attorney's testimony that he did not anticipate a legal malpractice claim was hard to believe.

As it is very rare that an insured would admit to a failure to disclose, the Court's unwillingness to accept the attorney's self-serving statement made during litigation as even creating an issue of fact for trial is a significant development that insurers should be aware of when handling matters regarding a failure to disclose potential claims.

Should you require any additional information, please do not hesitate to contact us.