

News & Alerts

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Your Colleague's Fraud Could Void Your Professional Liability Insurance

Professional firms typically rely on professional liability policies to shift risk from their personal and corporate assets to insurance. All types of professional service providers – lawyers, accountants, engineers, architects and consultants – utilize professional liability policies to back stop human error and errant colleagues. A dishonest or careless colleague, however, could void all coverage under a professional liability policy.

Last week, the Illinois Supreme Court found that the “innocent insured doctrine” did not protect unsuspecting colleagues from rescission of a professional liability policy due to misrepresentations made by a colleague. In *Illinois State Bar Ass'n Mut. Ins Co. v. Law Office of Tuzzolino and Terpinas*, 2015 IL 17096 (Feb. 20, 2015), a law firm renewed its professional liability policy. One of the firm's partners, Tuzzolino, was tasked with completing and submitting the insurer's Renewal Quote Invoice and Acceptance form. Despite recently having made a settlement overture to a former client to avoid a potential malpractice claim, Tuzzolino failed to disclose the potential claim on the renewal form. Instead, Tuzzolino responded “No” to the question, “Has any member of the firm become aware of a past or present circumstance(s), error(s) or omission(s), which may give rise to a claim that has not been reported?” Tuzzolino also certified his response and the contents of the application as true and complete to the best of his knowledge.

About a month later, another partner learned of the malpractice claim and promptly reported it to the liability insurance carrier. The carrier brought suit against the firm and the partners to rescind the liability policy on the basis that Tuzzolino's material misrepresentation in the application voided the entire policy. The trial court found that the insurer had no duties under the policy due to the fraud. The intermediate appeals court, however, reversed this decision. The appeals court found that the reporting partner was an “innocent insured” entitled to coverage even if Tuzzolino was not. The appeals court relied on the “innocent insured doctrine.” Under this common law concept, where a policy applies to two or more insured and one commits an act that would void the insurer's obligations, coverage is preserved for the remaining insureds who have not participated in the wrongdoing.

The Illinois Supreme Court disagreed. The “innocent insured doctrine,” it found, should not apply where a policy is rescinded based on fraud, rather than potentially rendered inapplicable

due to an exclusion triggered by the act of an insured. The Supreme Court rejected the insured's argument that public policy should preserve, not vitiate, coverage.

The Supreme Court distinguished between applying the innocent insured doctrine to block the application of exclusions, versus situation in which the existence of the policy itself is voided through misconduct in the application process leading to rescission. In the case of rescission, the policy never comes into existence. Where the application of an exclusion is at issue, however, the policy comes into existence but its coverage might be avoided by virtue of the exclusion.

At its core, the Illinois Supreme Court found that the fraud on the application was fatal to coverage for all insureds. The innocence of some insureds is irrelevant to a rescission analysis. In rescission, the focus of the analysis is on the effect of a misrepresentation on the formation of the policy, not the innocence of other insureds. Whether the policy came into being was an issue of statute and contract law, not an issue of its impact or the innocence of others.

Because the application fraud was material to the risk undertaken by the insurer, the Supreme Court found that Illinois statutory law voided the policy in its entirety – as if it had never come into existence. As a result, there was no coverage for any member of the firm.

The *Tuzzolino* case is a strong reminder that the process of applying for insurance must be treated as a serious and significant exercise. Professionals must take the time to properly detect, vet and report potential claims and to pick a company representative who will interact truthfully and carefully with the insurer. Policyholders should not assume that innocent members will be protected against the impacts of the fraud or carelessness of another member.

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