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New Jersey Supreme Court Upholds Insurer's Right to Rescind When Professional Liability Insurance Is Procured by Fraud

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On December 1, 2015, in DeMarco v. Stoddard, the ***New Jersey Supreme Court***, in a 5–2 decision, reversed an Appellate Division decision, *DeMarco v. Stoddard*, 434 N.J. Super. 352 (App Div. 2014), and held in favor of the insurance company in upholding an insurer's right to rescind when professional liability insurance is procured by fraud.

Background

DeMarco involved a podiatrist who practiced in New Jersey and Rhode Island. To get favorable malpractice insurance rates, the podiatrist applied to the Rhode Island Joint Underwriting Association (RIJUA) and lied on his application, purporting that his practice was predominantly in Rhode Island. This coverage of $1 million from the RIJUA allowed the podiatrist to comply with a New Jersey statute mandating medical malpractice coverage for New Jersey physicians and podiatrists of $1–$3 million.

One of the podiatrist's New Jersey patients was injured through malpractice and sued, ultimately adding the RIJUA into the lawsuit, seeking a declaration of coverage. The trial court and Appellate Division both found fraud in the application, but nevertheless did not allow the coverage to be rescinded, as it would harm the injured patient. Those lower courts analogized the situation to New Jersey law on automobile insurance, where because of statutory requirements of coverage, courts will not allow rescission of auto policies. The lower courts noted the statutory requirement of medical malpractice coverage and applied the automobile coverage model to this situation, forbidding rescission of the policy once an injured plaintiff has been hurt through malpractice. The lower courts analyzed New Jersey and Rhode Island law and concluded that both states would protect the innocent third-party claimant who made a malpractice claim before the policy was rescinded.

NJ Supreme Court Opinion

In a lengthy majority opinion, with a strong dissent, the New Jersey Supreme Court rejected the

arguments against rescission. The Court found that the lower court's reliance "on the compulsory automobile liability insurance model was misplaced. Its reliance on that model also ignored New Jersey's longstanding rule that an insured professional cannot expect insurance coverage to respond to third-party claims when the professional liability insurance has been rescinded due to misrepresentations of material fact in the application."

The Court concluded that the resolution of the issue of what, if any, coverage is available to an insured to respond to third-party claims following rescission of a policy is governed by the rule announced in *First American Title Insurance Co. v. Lawson*, 177 N.J. 125 (2003), and *Liberty Surplus Ins. Corp. v. Nowell Amoroso, P.A.*, 189 N.J. 436, 446–49 (2007). Those cases hold that a legal malpractice insurance policy may be declared void from its inception due to a misrepresentation of material fact by the insured in an application for insurance and that upon rescission, the insurer owes no duty to defend or indemnify the law firm or any defalcating attorney of the firm for any complaints pending or claims that accrued at the time of rescission. Applying that rule, the RIJUA owed neither a duty to defend nor a duty to indemnify its insured, who had misrepresented the proportion of his practice generated in Rhode Island, which was a fact that formed the basis for his eligibility for insurance through the RIJUA.

Conclusion

This decision is a win for insurance companies and avoids the Appellate Division ruling becoming the law of New Jersey, which would have effectively decimated the right to nullify an insurance policy procured by fraud in the face of a statute or court rule mandating the need for liability insurance.

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