

Fraud by Physician in the Application Process Does Not Preclude Insurance Recovery by Injured Plaintiff

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The recent Appellate Division Decision in Demarco v. Stoddard, Docket No. A-3924-12T1, 2014 N.J. Super. LEXIS 13 (January 22, 2014), preserves some insurance proceed recovery for an injured plaintiff when an insurer seeks to rescind a policy because of misrepresentation in the application process. In Demarco, a patient sued a doctor for malpractice. The doctor's insurance carrier disclaimed coverage on the theory that coverage had only been granted due to material misrepresentations having been made on the application. The court found that while material misrepresentations had been made, the innocent patient, who is an unnamed third-party to the insurance contract, should not be forced to suffer as a result of the misrepresentations. Accordingly, instead of rescinding the policy in its entirety, the court looked to the rational applied in auto insurance cases and used equitable principals to hold that the policy should be reformed to provide for the minimum amount of coverage required by law. In New Jersey, the minimal amount of insurance coverage doctors must carry is one million dollars.

Notably, the court distinguished First Am. Title Ins. Co. v. Lawson, 177 N.J. 125 (2003), a case that rescinded a legal malpractice insurance policy on the basis of misrepresentations in the application, because that was a case of subrogation between insurers where no innocent third-party was involved because the wronged client had already been made whole by the title insurance company who, in turn, sought reimbursement from the attorney's malpractice carrier.

Consequently, if Demarco succeeds in his malpractice case, the insurer is required to indemnify the doctor for the minimum amount mandated by the New Jersey law – one million dollars. Following the Demarco decision, we expect to see in any case where an insurer files a declaratory judgment action seeking to rescind a policy issued to a physician based on fraud in the application process, the plaintiff in the

underlying malpractice case, as a necessary party to the declaratory judgment action, will likely counterclaim for reformation of the policy to provide for the minimum limits of coverage required to be carried by the professional being sued.

