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Cont'l Cas. Co. v. Marshall Granger & Co., LLP ("Marshall Granger"), 2014 U.S. Dist. LEXIS 37008 (S.D.N.Y. Mar. 20, 2014

In a recent rescission action, *Cont'l Cas. Co. v. Marshall Granger & Co., LLP* ("Marshall Granger"), 2014 U.S. Dist. LEXIS 37008 (S.D.N.Y. Mar. 20, 2014), the U.S. District Court for the Southern District of New York held that an accounting firm's misrepresentations in an insurance application were material as a matter of law, even though the Insurer had not produced documentation concerning its underwriting practices to show materiality. The court held that "[c]ommon sense dictates that it is simply impossible to believe that, had the full facts regarding [the insured's] fraudulent scheme been disclosed on the Application, [the Insurer] would still have issued the Policy on the same terms."

Continental Insurance issued an Accountants Professional Liability Insurance Policy to accounting firm Marshall Granger, pursuant to a Renewal Update application, which was filled out and signed by the insured's owner and manager, Laurence Brown. The application included several questions regarding whether Marshall Granger promoted investment ventures, and whether Marshall Granger was aware of any act, omission, circumstance or fee dispute which might be expected to be the basis of a claim or suit. Brown answered "No" to each of the questions. Continental issued the Policy in reliance on the responses provided in the Application.

Subsequently, it was discovered that Brown was in the midst of perpetuating a Ponzi fraud scheme, "duping several of his accounting clients into participating in a nonexistent investment opportunity" at the time that Brown submitted the Application. Subsequently, the SEC initiated an enforcement action against Brown, and Marshall Granger co-owner Ronald Mangini alleging, among other things, that that Brown and Mangini had been selling fictitious stock and promissory notes as part of a scheme yielding over $2.1 million in fraudulently obtained profits from at least thirteen investors. Brown was subsequently indicted by a grand jury. Insurer Continental filed a rescission action.

In its ruling regarding rescission, the court noted that it was clear, and that the parties did not seriously dispute, that Brown made misrepresentations in the Application submitted to Continental. In dispute, however, was whether Continental had met its burden of proving that the misrepresentations were material under New York Law. Under New York law, to establish materiality as a matter of law, the insurer has typically been required to present documentation concerning its underwriting practices to establish that it would not have issued the same policy if the correct information was disclosed. Although the court held that Continental had not satisfied its burden under New York law of producing documentation concerning its underwriting practices to show materiality, the court held that "Brown's misrepresentations were material as a

matter of law. Based on all the evidence presented, no rational finder of fact could possibly conclude otherwise." The court agreed with the reasoning of the Insurer's testimony that "[t]here is no specific underwriting guideline in the Guidelines regarding whether to issue a policy where an insured is engaged in an ongoing fraudulent enterprise. In [the underwriter's] view, such a guideline is unnecessary because it is patently obvious that [such] a policy should not be issued." Thus, the court held that since discovery failed to uncover any evidence to undermine the "obvious materiality" of the misrepresentations, the misrepresentations contained in the Application were material as a matter of law and granted partial summary judgment to Continental on this issue.

The court, however, allowed Marshall Granger additional discovery to determine whether the timing of Continental's rescission constituted an unreasonable delay. The court noted, however, that public policy supports the allowance of a reasonable investigation and that "it would be unwise to give insurers an economic incentive to rescind insurance at the drop of a hat and without sufficient investigation. Such willy-nilly actions would obviously result in less insurance coverage, but also would engender countless lawsuits." Further, the court noted that "There is no bright-line rule as to when the length of a rescission investigation becomes unreasonable or how long the insurer is entitled to consider whether or not to pursue rescission after completing its investigation.

The court also held that Continental did not waive its rights to pursue rescission through issuance of two administrative endorsements that changed the name of the insured, payment of defense costs as required by the policy, and notice of non-renewal and offer of extended reporting period coverage.