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NEWSLETTER

Materiality and Timeliness - Issues of Fact in Insurer's Rescission Action

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A court has declined to grant summary judgment to a lawyers professional liability insurer in a rescission action on the grounds that the affidavit from the underwriter was overly conclusory regarding the materiality of the misrepresentations in the policy application received from the prospective insured. *See Chicago Ins. Co. v. Kreitzer & Vogelman,* No. 97 Civ. 8916 (RWS), 2000 U.S. Dist. LEXIS 80 (S.D.N.Y. Jan. 10, 2000). The court also concluded that issues of fact remained concerning whether the insurer timely sought to rescind the policy.

On December 30, 1994 the law firm of Kreitzer & Vogelman ("K&V") applied for a claims-made professional liability policy from Chicago Insurance Company ("CIC"). The insured's application denied knowledge of any potential claims against the firm or its attorneys and did not respond to an inquiry regarding whether any attorney had been the subject of disciplinary proceedings. On March 21, 1995, the firm submitted a supplemental form informing the insurer of one claim involving attorney Kreitzer's failure to enter judgment within one year of default. CIC issued a policy effective March 26, 1995 to March 26, 1996.

Attorney Kreitzer had, however, been notified in August of 1993 of charges of professional misconduct relating to three clients. These charges resulted in disciplinary hearings in December of 1993 and May of 1994. In February 1995 the charges were amended to include eight additional cases involving neglect of ongoing cases. Additional hearings were conducted in May and June of 1995. Nevertheless, in September of 1995, Kreitzer signed an acknowledgment from the policy broker that he was aware of no additional potential claims since the original application. In November of 1995, five more charges of misconduct were added to Mr. Kreitzer's disciplinary proceedings. In March of 1996, Kreitzer and K&V submitted an abbreviated renewal application, listing only a single additional potential claim involving a motion to reinstate a case that Mr. Kreitzer had allowed to be dismissed off of the trial calendar. CIC renewed the policy for an additional year, March 26, 1996 to March 26, 1997. On February 17, 1997, Mr. Kreitzer was suspended from legal practice. This suspension was a matter of public record.

Mr. Kreitzer subsequently transferred all of his files to Pariser & Vogelman ("P&V"). In March of 1997, P&V had several communications with CIC concerning Mr. Kreitzer's suspension, the management of his files and the large number of actions that would have to be dismissed because of Mr. Kreitzer's neglect. In April 1997, P&V purchased from CIC an unlimited extended reporting period for the 1996-97 policy, which extended indefinitely the time in which claims against K&V could be reported. In June 1997, CIC retained counsel to

evaluate its coverage obligations to K&V. In November 1997, CIC informed P&V of its intent to rescind both policies based upon K&V's material misrepresentations.

The court first held that CIC had failed to establish materiality of the misrepresentation as a matter of law. Reasoning that materiality requires the insurer to show that absent the misrepresentation the insurer would not have issued the policy in question, the court opined that a "conclusory" affidavit by an underwriter is insufficient to establish materiality for purposes of summary judgment. In particular, the court held that CIC failed to supply the court with any written underwriting standards demonstrating that, had K&V fully disclosed Mr. Kreitzer's disciplinary problems, the policy would not have been issued based on the guidelines.

The court then rejected the policyholder's contention that CIC failed to follow up on K&V's statement in the renewal application that new claims had been raised against K&V, concluding that K&V's listing of a single additional claim in the same application created the misimpression that there was only a single new claim. Second, the court held that the fact that Mr. Kreitzer's suspension was a matter of public record was insufficient to notify the insurer of the potential for claims, stating that there is "no authority suggesting that an insurance company has an affirmative obligation to scour all publicly-available information concerning individuals or entities to which it is, or has contemplated, providing coverage."

Lastly, the policyholders argued that CIC should be estopped from seeking recission because it had ample information concerning claims by the time it issued the extended reporting period endorsement, but nevertheless issued that endorsement and did not seek recission until seven months later. The court held that issues of fact remained concerning whether CIC should be estopped from rescinding the policy based on its delay in seeking recission. In so holding, the court rejected CIC's argument that it was required by law to offer the endorsement, concluding that a timely recission of the policy would equally have rescinded the legal obligation to offer the endorsement.

The decision regarding materiality is somewhat surprising in light of the plainly significant information that the insured withheld from the insurer. It suggests that, in order to obtain summary judgment on a rescission claim under New York law, an insurer may wish to flesh out the underwriting guidelines or standards that it employs in order clearly to demonstrate materiality. At the same time, the decision stands as helpful precedent for the proposition that an insurer is not deemed to be on notice of all adverse information concerning a prospective insured simply because the information exists on the public record. Finally, in noting that an insurer generally must move promptly to rescind a policy once it has a factual basis to do so, the court echoes the law of several jurisdictions that mandate similarly prompt action by an insurer.