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At an IAS Term, Part Comm-2 of the Supreme Court of the State of New York, held in and for the County of Kings, at the Courthouse, at Civic Center, Brooklyn, New York, on the 29th day of October, 2009.

P R E S E N T:

HON. DAVID I. SCHMIDT,

Justice.

- X

OLYMPIA MORTGAGE CORPORATION,

Plaintiff,

- against -

DECISION and ORDER

CERTAIN UNDERWRITERS AT LLOYD'S, LONDON, SELECT INSURANCE COMPANY AND GULF UNDERWRITERS INSURANCE COMPANY,

Index No. 29830/08

Defendants.

- X

The following papers numbered 1 to 12 read on these motions:	Papers Numbered
Notice of Motion/Order to Show Cause/ Petition/Cross Motion and Affidavits (Affirmations) Annexed with Exhibits	1-3 5-7
Statement/Counter Statement of Material Facts	4 8
Reply Affidavits (Affirmations)	9-12

In this insurance coverage action, defendants Certain Underwriters at Lloyd's, London, Select Insurance Group, and Gulf Underwriters Insurance Company (collectively, the Insurers or Underwriters) move for an order, pursuant to CPLR 3212 (b), granting them summary judgment dismissing the complaint. Plaintiff Olympia Mortgage Corporation (Olympia) cross-moves for an order, pursuant to CPLR 3212 (b), granting it summary judgment dismissing the Insurers' affirmative defense of rescission and for an order, pursuant to CPLR 3214 (b), lifting the statutory stay of disclosure.

Background

The Underlying Actions

In November 2004, Federal National Mortgage Association (Fannie Mae), a government-sponsored private entity that had purchased thousands of mortgages originated, and serviced, by Olympia, filed suit against Olympia, one of its senior officers, Leib Pinter (Leib), and, as later amended, Barry Goldstein, Olympia's owner and managing director (Barry), alleging fraud and breach of contract, and seeking the appointment of a receiver (*see Federal Natl. Mortg. Assn. v Olympia Mortg. Corp. and Leib Pinter*, 04 Civ 4971 [ED NY] [the Fannie Mae Action]). An equity receivership was promptly established for Olympia, and Karen Kincaid Balmer, a certified forensic accountant, was appointed as its receiver (the Receiver). In August 2007, a consent judgment was entered in the Fannie Mae Action against Olympia on Fannie Mae's claims in the amount of approximately $44 million, plus pre-judgment interest in accordance with CPLR 5001 (*see* Consent Judgment, § 5). In May 2008, Leib and Barry were indicted in connection with Olympia's fraudulent activities (*see United States v Leib Pinter and Barry Goldstein*, 08 Cr 297 [ED NY] [the Criminal Action]).

The record of these actions, of which the court takes judicial notice, reflects that Fannie Mae operated a streamlined refinancing program, whereby a homeowner who held an existing mortgage loan with Fannie Mae (an "A" loan) could refinance that mortgage loan at a lower interest rate by taking a new mortgage loan (a "B" loan). Fannie Mae issued this refinancing mortgage loan through mortgage bankers, such as Olympia. Upon the closing

of the refinanced mortgage loan (*i.e.*, a "B" loan), Fannie Mae would wire the proceeds of the "B" loan to Olympia. Under the terms of the Mortgage Selling and Servicing Agreement between Olympia and Fannie Mae, dated June 8, 1988, and its addenda, dated January 23, 1989, June 19, 1996, and March 7, 1997 (the Contract), Olympia was required to use the proceeds of the "B" loan to pay off the outstanding balance of the "A" loan. Because the "A" loan was also owned by Fannie Mae, Olympia was required to remit these proceeds to Fannie Mae. The "B" loan would then become the operative loan, and the homeowner would thereafter make monthly payments of the "B" loan, at a lower interest rate, to Olympia for remittance to Fannie Mae. According to the indictment, Leib utilized this system to defraud Fannie Mae by stealing the pay-off proceeds of 257 of these "A" loans that Olympia was servicing for Fannie Mae. The indictment alleged that rather than repay these loans as required under the terms of the Contract, Leib used the proceeds to pay Olympia's operating expenses and enrich himself and others (the refinancing fraud). As a result of the fraud in these 257 instances, both the "A" loans and the "B" loans remained outstanding. To prevent Fannie Mae from detecting the scheme, Leib caused Olympia to make monthly principal and interest payments on these "A" loans to Fannie Mae, thereby preventing these "A" loans from becoming delinquent. Meanwhile, the homeowners, unaware that their "A" loans had not been satisfied, made monthly payments on the corresponding "B" loans to Olympia which remitted them to Fannie Mae. The fraud was ultimately discovered in September 2004, Olympia was shut down in October 2004, and it surrendered its New York State mortgage

banking license in November 2004. Leib was sentenced, based on his plea of guilty to one count of indictment for the refinancing fraud, to a prison term of 97 months and ordered to pay restitution in the amount of approximately $44 million, in March 2009. Although Barry was not charged with respect to the refinancing fraud, he was charged with two felony counts in connection with another larcenous scheme in which Olympia sold to Credit Suisse First Boston twelve non-performing mortgage loans using falsified loan histories. Barry pled guilty to one felony count in connection with the latter scheme, in January 2009. He has not yet been sentenced.

The Fidelity Bond

As part of its relationship with Fannie Mae, Olympia was required to "maintain, at its own expense, a fidelity bond and errors and omissions insurance," in accordance with the Fannie Mae Guides (*see* Contract, § V [A] [3]). Fannie Mae's 2002 Selling Guide, effective June 30, 2002, provided, in relevant part, that:

> Each lender [Olympia in this case] must have a blanket fidelity bond and an errors and omissions insurance policy in effect at all times . . . These policies must insure the lender against losses resulting from dishonest or fraudulent acts committed by the lender's personnel, any employees of outside firms that provide data processing services for the lender, and temporary contract employees or student interns. The fidelity bond should also protect us [Fannie Mae] against dishonest or fraudulent acts by the lender's principal owner, if the lender's insurance underwriter provides that type of coverage . . .
>
> Each fidelity bond or errors and omissions insurance policy must include the following provisions (when they can be obtained):
>
> - Fannie Mae must be named as a "loss payee" on drafts the insurer issues to pay for covered losses that we incur; [and]

- Fannie Mae must have the right to file a claim directly with the insurer if the lender fails to file a claim for a covered loss that we incur . . .

(Part I, § 305 [Fidelity Bond and Errors and Omissions Coverage]).[1]

In January 2004, Barry, as Olympia's managing director, applied to Bankers Insurance Service Inc., a broker, for renewal of its mortgage bankers bond which was due to expire in February 2004. The broker provided Olympia with a Short Form Renewal Application for a Mortgage Bankers Bond (Form 500 8/01) (the Application), which asked for certain information to enable the Insurers to determine whether to accept the risk. Among other things, the Application requested that Olympia submit to the Insurers its current audited financial statements certified by a CPA and, if the current audited financial statements were more than six months old, its most current unaudited interim financial statements as well. In response to this request, Olympia submitted, *inter alia*, its audited financial statements for the fiscal years ended December 31, 2002 and December 31, 2001, as well as its unaudited financial statements for the first nine months ended September 30, 2003. These financial statements, both audited and unaudited, indicated that Olympia was solvent, profitable, and solidly capitalized. In particular, the audited financial statements indicated that Olympia had retained earnings of approximately $5.3 million for the fiscal year ended December 31, 2002 and total stockholders' equity of approximately $6.8 million as of December 31, 2002. In

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[1] Fannie Mae's 2002 Selling Guide, which was in effect at the time Olympia applied for the subject Bond, is available at http://www.allregs.com/efnma/toc/ toc.asp?path=fnma/selling (accessed Oct. 16, 2009). Fannie Mae's 2005 Servicing Guide, which is also available at the same website, contains the identical fidelity bond requirements. Fannie Mae's 2002 Servicing Guide does not appear to be available on line.

addition, the unaudited financial statements represented that Olympia had total income from its operations of approximately $5.6 million for the first nine months of 2003 and total stockholders' equity of approximately $8.2 million as of September 30, 2003.

The Declaration Clause of the Application provided that the applicant, Olympia, should sign the following:

> WE DECLARE THAT THE STATEMENTS AND PARTICULARS IN THIS APPLICATION ARE TRUE AND THAT WE HAVE NOT MISSTATED OR SUPPRESSED ANY MATERIAL FACT(S).

On or about January 12, 2004, Barry signed the Application as Olympia's managing director.

Some time thereafter, Novae Syndicates Ltd., a member of the Lloyd's of London insurance market (the Lead Insurer), issued to Olympia, on behalf of the Insurers, Mortgage Bankers Bond no. MBB-03-00195 for the period of February 15, 2004 to February 15, 2007 (the Bond). The Bond started (at page 3) with the following Insuring Clauses or Sections:

> The Underwriters hereby undertake and agree, subject to the terms, definitions, limitations, conditions and endorsements of this Bond,
>
> (a) with respect to Sections A, B, C, D and E (2) to indemnify the Assured [defined as Olympia and its section 401 (k) plan] for loss to the Assured;
>
> (b) with respect to Section E (1) to pay on behalf of the Directors and Officers, or to reimburse the Company, as the case may be, for loss to such Directors and Officers or Company; in the manner and to the extent described herein.[2]

The Bond offered Olympia a menu of five potential areas of coverage: fidelity/crime coverage, including dishonesty under Insuring Clause A1; partner, sole proprietor or major

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[2] Bold-faced type has been omitted from citations to the Bond and its endorsements.

shareholder coverage consisting of theft of secondary market institution's (*i.e.*, Fannie Mae's) money or collateral under Insuring Clause B1; coverage for mortgagee's specified errors and omissions under Insuring Clauses C1 and C2; coverage for losses caused by professional services under Insuring Clause D; and certain coverage for directors, officers, and company (Insuring Clause E). Olympia bought coverage under Insuring Clauses (or Sections) A, B, and C, and no coverage under Sections D or E. The distinction between Sections A, B, and C, on the one hand, and Sections D and E, on the other hand, was noted in the Bond's warranty, which stated, in relevant part:

> For the purposes of Sections D and E only:
>
> It is warranted that the particulars and statements contained in the Application, a copy of which is attached hereto, are the basis of this Bond and are to be considered as incorporated into and constituting a part of this Bond.
>
> By acceptance of this Bond the Assureds agree:
>
> (i) that the statements in the Application are their representations, that they shall be deemed material to the acceptance of the risk or the hazard assumed by Underwriters under this Bond and that this Bond is issued in reliance upon the truth of such representations;
>
> (ii) that in the event that the Application contains misrepresentations made with the actual intent to deceive, or contains misrepresentations which materially affect either the acceptance of the risk or the hazard assumed by Underwriters under this Bond, this Bond in its entirety shall be void and of no effect whatsoever; and
>
> (iii) that this Bond shall be deemed to be a single unitary contract and not a severable contract of insurance or a series of individual contracts of insurance with each of the Assureds.

(Condition X [Warranty], ¶ 2).

As is pertinent to this case, the Bond satisfied Olympia's contractual requirements to Fannie Mae as set forth in the Contract and the Selling Guide. It contained the necessary coverage under Sections A and B as required by Fannie Mae. Further, the Bond named Fannie Mae as a loss payee (*see* General Loss Payee Endorsement [All Clauses], dated Dec. 23, 2004 ["in the event of a loss affecting the interest of Fannie Mae Home Loans . . . , then Fannie Mae Home Loans shall be named on the loss payable draft as its interest may appear"]).

Cancellation of the Bond; Subsequent Events

Following Olympia's collapse, the Insurers issued a Notice of Termination endorsement, dated December 23, 2004, notifying Olympia that the Bond would be terminated as of 12:01 a.m. on January 17, 2005. The Notice of Termination stated that it was issued in accordance with Condition M (Termination), ¶ 1 (a), which provided that "[t]his Bond shall terminate as an entirety upon the earliest occurrence of any of the following: . . . sixty (60) days after the receipt by the Assured of a written notice from the Underwriters of their decision to terminate this bond . . ." The endorsement further stated that "[a]ll other terms, insuring clauses, definitions, exclusions, limitations, conditions and endorsements of the attached Bond remain unchanged."

On October 24, 2005, the Receiver submitted a proof of loss under Section A (Insuring Clause A1 [dishonesty]) and Section B (Insuring Clause B1 [theft of secondary market institution's money or collateral). The proof of loss was based on the refinancing

fraud described above as well as on two additional schemes allegedly perpetrated by Olympia: the "family member payroll" fraud, whereby fourteen family members of Olympia's principals, including those of Leib and Barry, had been placed on Olympia's payroll but performed no work for Olympia; and the "KSH" fraud, whereby Olympia made payments to a non-profit entity that was controlled by another Olympia principal, Sidney "Sam" Pinter (Leib's younger brother), and Sam's wife, for no consideration.

On December 11, 2007, the Receiver was examined under oath about the nature and extent of the alleged loss. In her testimony, she provided additional detail on the three types of fraud asserted in Olympia's proof of loss. She stated (at pages 84-86) that the refinancing fraud was perpetrated by Leib, Barry, and another individual (Patricia Trinidad) over at least a three- or four-year period before Olympia's collapse in October 2004. She further stated (at pages 117-126) that the family member payroll fraud was perpetrated by all four principals of Olympia (Leib, Barry, Sam, and Avruhum Donner), and that it took place over at least a six-year period before Olympia's collapse. Next, she stated (at pages 163 and 171-185) that the KSH fraud was perpetrated by Sam and Barry over at least a six-year period before Olympia's collapse, and she specifically identified Sam and Barry as the signatories to the checks by which Olympia made payments to KSH. In addition, she described (at pages 239-251) several other fraudulent schemes perpetrated at Olympia, including the "Jasmine Lakes Properties Scheme," whereby Leib and Barry wrongfully diverted Olympia's funds to develop an apartment housing project in South Florida in which

Leib and Barry each owned 15%,[3] and the "Barring Shields Scheme," whereby Leib and Barry improperly used some of Olympia's money to finance a day-trading firm which later failed.

By letter, dated June 17, 2008, the Insurers disclaimed coverage under the Bond, asserting, among other things, that the Bond had been obtained through fraud in the inducement and, therefore, had been void from its inception. On October 31, 2008, Olympia filed the instant action against the Insurers for breach of contract and seeking payment of $2.7 million under the Bond.[4] On January 30, 2009, the Insurers interposed an answer asserting an affirmative defense of rescission, which is the subject of the Insurers' and Olympia's instant motions.

Discussion

The Warranty Clause

The threshold issue, raised by Olympia, is whether the Insurers are precluded by the terms of the Bond from seeking to rescind it. Olympia argues that Condition X (Warranty), ¶ 2 permitted the Insurers to void the Bond for fraud in the Application with respect to

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[3] The ownership interest is based on Barry's deposition testimony in the Fannie Mae Action (at pages 331-332).

[4] In accordance with the agreement between the Receiver and Fannie Mae, the Receiver is to pursue Olympia's claims under the Bond (*see* Unsworn Affidavit of Karen Kincaid Balmer, dated June 23, 2009, ¶ 2). Pursuant to Condition E (Right of Action by Assured or Institution), ¶ 2 (Institution), Fannie Mae is not permitted to assert a direct claim against the Insurers where, as here, Olympia is pursuing it. Although the instant action is being prosecuted by Olympia, rather than by the Receiver on Olympia's behalf, no issue has been raised concerning Olympia's standing.

coverage under Sections D and E only. Because no coverage was bought under Sections D or E, Olympia contends that the Insurers may not rescind the Bond on account of any alleged fraud in the Application with respect to Sections A, B, or C. The Insurers' response is that Condition X, ¶ 2 was an additional, non-exclusive basis for rescinding the Bond for those insureds who, unlike Olympia, bought coverage under Sections D or E. The court agrees with the Insurers.

As is clear from the language of Condition X, ¶ 2, which used the term "Assured" in its plural form, this condition applied to multiple insureds because Sections D and E provided third-party liability coverage which protected both the mortgage bank and certain of its employees. Thus, if the mortgage bank were to buy the applicable coverage (here, Olympia did not), this condition would treat the Bond as a "single unitary" contract, which would enable the Insurers to rescind the entire Bond in case of misrepresentations made by one of the Assureds, even if the other Assureds had no knowledge of such misrepresentations (*see INA Underwriters Ins. Co. v D.H. Forde & Co., P.C.*, 630 F Supp 76, 77 [WD NY 1985] [the entire policy was rescinded as to all of the insureds because the policy was deemed to be a single unitary contract]). Given this purpose, the warranty contained in Condition X, ¶ 2 has no relevancy to a claim, such as Olympia's, under Sections A and B, which provided first-party coverage to just one Assured (*i.e.*, Olympia), and not third-party coverage to multiple Assureds under Sections D and E.

Logic and common sense dictate the same result. It cannot be disputed that an insurance contract may be rescinded based on a revelation that there was fraud from its inception (*see SEC v Credit Bancorp, Ltd.*, 147 F Supp 2d 238, 256 [SD NY 2001], *reconsideration denied* 2001 WL 1135652 [SD NY 2001]). Even if Condition X, ¶ 2 were deemed to be an express waiver by the Insurers of their contractual right to rescind the Bond, such waiver would be ineffective if the Bond were void under Insurance Law § 3105 from the very beginning, which is what the Insurers argue here (*see Precision Auto Accessories, Inc. v Utica First Ins. Co.*, 52 AD3d 1198, 1201 [4th Dept 2008] ["when an insurance policy is void *ab initio* based on material misrepresentations in the application, it is as if the policy never came into existence, and an insured cannot create coverage by relying on the terms of a policy that never existed"], *lv denied* 11 NY3d 709 [2008]).

Rescission Under Insurance Law § 3105

The central issue before the court is whether the Insurers are entitled to rescind the Bond under New York law, which the parties agree is applicable. Insurance Law § 3105 (a) defines a representation as a "statement as to past or present fact, made to the insurer . . . at or before the making of the insurance contract as an inducement to the making thereof," and "a misrepresentation is a false representation, and the facts misrepresented are those facts which make the representation false." "[M]aterial misrepresentations . . . if proven, would void the . . . insurance policy *ab initio*" (*Tyras v Mount Vernon Fire Ins. Co.*, 36 AD3d 609, 610 [2d Dept 2007] [internal citation omitted]). Rescission is available even if the material

misrepresentation was innocently or unintentionally made, and whether or not the insured intended to provide inaccurate statements or misrepresentations is irrelevant (*see Curanovic v New York Cent. Mut. Fire Ins. Co.*, 307 AD2d 435, 436 [3d Dept 2003]; *Kulikowski v Roslyn Sav. Bank*, 121 AD2d 603, 605 [2d Dept 1986], *appeal dismissed* 69 NY2d 705 [1986], *rearg denied* 69 NY2d 900 [1987]).

In this case, Olympia does not contest that the financial statements it submitted in connection with the Application for the Bond were false and misleading (*see* Olympia's Response to Statement of Material Facts, Olympia's Counter Statement 67, at 24). In addition, the Receiver testified at her examination under oath (at pages 237-238; 266-269) that Olympia had been insolvent since at least 1997, and that the above-described fraudulent schemes had taken place over a several year period before the Bond became effective in February 2004 (at pages 85-86, 117-162, 171-179, 239-242, 267-269). Finally and crucially, Olympia admitted the refinancing fraud in the Consent Judgment entered in the Fannie Mae Action.

Given the magnitude of Olympia's fraud, whether the Bond was obtained through misrepresentations in its financial statements seems straightforward. Remarkably, however, the Insurers have failed to make a prima facie showing that such misrepresentations were material. Under New York law, a misrepresentation is considered "material" if "knowledge by the insurer of the facts misrepresented would have led to a refusal by the insurer to make such a contract" (Insurance Law § 3105 [b]). Whether a misrepresentation is material is

generally a question of fact for the jury (*see Barkan v New York Schools Ins. Reciprocal*, 65 AD3d 1061 [2d Dept 2009]). "In determining the question of materiality, evidence of the practice of the insurer which made such contract with respect to the acceptance or rejection of similar risks shall be admissible" (Insurance Law § 3105 [c]). This evidence should take the form of "documentation concerning its underwriting practices, such as underwriting manuals, bulletins, or rules pertaining to similar risks" (*Barkan*, 65 AD3d at 1061). "Conclusory statements by insurance company employees, unsupported by documentary evidence, are insufficient to establish materiality as a matter of law" (*Parmar v Hermitage Ins. Co.*, 21 AD3d 538, 540 [2d Dept 2005]).[5]

By way of illustration, in *Chicago Ins. Co. v Kreitzer & Vogelman*, 2000 WL 16949 [SD NY 2000]), an insurer moved for summary judgment declaring the propriety of its rescission of certain professional malpractice liability policies based on the failure by the insured attorney to disclose, at the time when he applied for the subject policies, the then-pending disciplinary charges and numerous client claims against him. The disciplinary charges at issue were so serious that the insured attorney was later disbarred by the Appellate Division, First Department. To establish materiality of the subject misrepresentations, the insurer relied solely on the affidavit of its underwriter. The underwriter explained that because the insured's non-disclosures and misrepresentations were "unprecedented," the

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[5] *See also Executive Risk Indem. Inc. v Pepper Hamilton LLP*, 2009 WL 3347222 (Ct App, Oct. 20, 2009) ("the self-serving affidavit of [the] underwriter – that [the insured's] renewal application would have been treated differently had it disclosed the underlying circumstances which led to the denial of coverage – is insufficient to meet the insurer's heightened burden of proof").

underwriting guidelines did not address such "an extraordinary situation" (*id.* at 7, n 7). The United States District Court for the Southern District of New York held that the underwriter's affidavit, standing alone, was insufficient to establish the element of materiality as a matter of law and denied its motion (*id.* at 7). Thereafter, the insurer again moved for summary judgment, reiterating that its rescission of the policies was proper. The insurer contended that under unique circumstances of that case it had no evidence of its underwriting practices beyond its underwriter's affidavit. The District Court again denied the insurer's motion, adhering to its prior holding that additional evidence was mandatory in order for the insurer to prevail on summary judgment under New York law. The District Court faulted the insurer for its failure "to present corroborating evidence," despite the insurer's frank admission that "no such evidence is available as there were no [relevant] guidelines in effect"(*Chicago Ins. Co. v Kreitzer & Vogelman*, 210 F Supp 2d 407, 413 [SD NY 2002]).

Here, the Insurers have submitted the Lead Insurer's affidavit, stating that "[a]t the time that the Bond was negotiated and issued, Novae [the Lead Insurer] *preferred* to issue policies to financial institutions which were solvent and in a good financial standing and avoid those which were insolvent or in poor financial condition" (*see* Allen Affidavit, May 21, 2009, ¶ 5 [emphasis supplied]). "A financial institution which is solvent and in good financial standing is a *desirable* type of insured to do business with because it *tends* to produce a manageable loss experience, which itself *tends* to reflect an adequate level of staffing, proper security systems, competent management, and effective internal accounting

controls" (¶ 5 [emphasis supplied]). "On the other hand, a financial institution which is insolvent or in poor financial condition *tends* to produce an unmanageable loss experience and *often* possesses inadequate staffing, security systems, management, and internal controls" (¶ 5 [emphasis supplied]). Thus, "[h]ad Olympia submitted truthful and accurate financial statements in its Application, its insolvency would have been disclosed and Novae would have declined to issue the Bond to Olympia. By submitting false financial statements and concealing its insolvency, Olympia deprived Novae of the opportunity to accurately assess the underwriting risk associated with issuing the Bond to Olympia" (¶ 15). In its reply affidavit, the Lead Insurer states that it "does not maintain an 'underwriting manual' with regard to its underwriting policies for mortgage banks," and "the issue of whether an underwriter will agree to participate on a risk is a matter of underwriting discretion" (*see* Allen Reply Affidavit, dated July 1, 2009, ¶ 2), *i.e.*, on an ad hoc basis.

It is self-evident that the Lead Insurer's affidavits are overgeneralized and conclusory. The opening affidavit repeatedly uses the same words or word groups – "loss experience," "level of staffing," "security systems," "management," and "internal accounting controls" – and adds the vague qualifiers "manageable" and "adequate," or "unmanageable" and "inadequate," when it suits its purposes. Thus, either the "loss experience," "level of staffing," etc. are "manageable" and "adequate" (whatever they may be) for an entity that the Lead Insurer *prefers* to insure; or, in the alternative, the "loss experience," "level of staffing," etc. are "unmanageable" and "inadequate" for an entity that it prefers *not* to insure (*see* Allen

Affidavit, May 21, 2009, ¶¶ 5-6). The Lead Insurer has offered no supporting documentary evidence, such as manuals, bulletins, or rules pertaining to similar risks. It has not identified any mortgage banks or other similarly situated applicants whom it has rejected in the past. The Insurers here should have done more than merely offer their Lead Insurer's affidavits stating generally, without a shred of documentary proof, supporting rules or manuals, or their past experience, to buttress the conclusion that the Application for the Bond would not have been accepted if they had received accurate financial statements from Olympia. Accordingly, the Insurers have failed to make a prima facie showing of entitlement to summary judgment under New York law, and their motion is denied (*see Barkan*, 65 AD3d at 1061).

The Insurers have cited to this court only one decision in which an insurer was apparently permitted to utilize solely an underwriter's affidavit (or declaration) to establish materiality of the insured's misrepresentations in the application (*see In re Payroll Express Corp.*, 216 BR 344, 357 [SD NY 1997], *affd* 186 F3d 196 [2d Cir 1999]). The *Payroll Express* case, however, was decided under New Jersey law (*id.* at 358), and, therefore, is "not persuasive" (*see Kreitzer & Vogelman*, 210 F Supp 2d at 412). The law of New Jersey on this point is inapposite because "an insurer seeking rescission of a policy under New Jersey law need not necessarily provide the supporting documentation required by New York law. Express language in a policy explaining that the insurance was issued in reliance upon the truthfulness of the applicant's representations, along with sworn statements by insurance company employees that the insured's misrepresentations affected their risk assessment and

ultimate decision to issue coverage, will suffice" (*Evanston Ins. Co. v Biomedical Tissue Serv., Ltd.*, 2007 WL 4180653 [ED NY 2007], *report and recommendation adopted* 2007 WL 4180619 [ED NY 2007]). Accordingly, the *Payroll Express* case does not support a contrary result.

The Effect of Prior Cancellation

The next issue is whether the Insurers have waived (or are equitably estopped from asserting) their rescission rights by virtue of their prior cancellation of the Bond. In *Stein v Security Mut. Ins. Co.* (38 AD3d 977, 978-979 [2007]), the Appellate Division, Third Department, concluded that even where a defendant insurer "could have rescinded plaintiffs' policy, rendering it void *ab initio*," based on material misrepresentations in the application, it was not free to do so once the insurer "elected to cancel plaintiffs' policy rather than rescind it." In *Stein*, plaintiffs misrepresented certain aspects of their insurance history in their application for homeowners' insurance. As a result, the insurer sent plaintiffs a notice that their policy would be canceled approximately one month later. In the interim, plaintiffs' home was damaged, and they sought coverage under the fraudulently procured policy. Thereupon, the insurer denied coverage, declared the policy void from its inception, and returned plaintiffs' premium. The court, however, required the insurer to pay plaintiffs' claim, holding that its prior cancellation of the insurance contract barred its later attempt to rescind the policy.

Here, the Insurers terminated or canceled the Bond in December 2004, effective January 2005. Despite their earlier cancellation, they are now seeking to rescind the Bond as if it never existed. These two actions are inconsistent with each other. At issue is how much the Insurers knew about Olympia's fraud when they canceled the Bond. At that time, Olympia already had been shut down, its mortgage banking license had been surrendered, the Receiver had been appointed, and the complaint laying out the refinancing fraud in detail had been filed in the Fannie Mae Action. Moreover, the haste with which the Insurers canceled the Bond without affording Olympia the full 60-day prior notice required under the termination condition of the Bond leaves the court to wonder about the extent of information which the Insurers possessed or to which they were privy.[6] This is an additional reason for denying summary judgment to the Insurers where, as here, "there is any doubt, at least any significant doubt, whether there is a material, triable issue of fact" (*Phillips v Joseph Kantor & Co.*, 31 NY2d 307, 311 [1972]).[7]

In light of these unresolved issues, Olympia's request to strike the Insurers' affirmative defense of rescission is similarly denied. Olympia's outstanding document request, which the Insurers have not answered, is designed to disclose just the sort of

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[6] At some point in time not disclosed in the record, Fannie Mae had submitted, on its own, a proof of loss to the Insurers under the Bond before the Receiver submitted her proof of loss on behalf of Olympia.

[7] In light of the foregoing, the court need not address the Insurers' alternative argument that they are entitled to rescission based on Barry's allegedly false answer to question no. 25 in the Application.

evidence which is necessary in order to evaluate properly the questions of materiality and potential waiver/equitable estoppel. Full discovery – and none of it had been conducted before the subject motions were made – should proceed (*see Wittner v IDS Ins. Co. of New York*, 96 AD2d 1053 [2d Dept 1983]).

Fannie Mae's Rights

The final matter is whether Fannie Mae, as a loss payee, has an independent right to be indemnified under the Bond, regardless of Olympia's misconduct. The Contract and the Selling Manual required that Fannie Mae "be named as a 'loss payee' on drafts the insurer issues to pay for covered losses that we incur." Consistent with this requirement, the Bond provided that in the event of a loss Fannie Mae would be named on a loss payable draft "as its interest may appear." Significantly, however, the Bond did not provide that Fannie Mae's interest could not be impaired by acts or neglect of Olympia. Moreover, Fannie Mae has no direct right of action against the Insurers where, as here, Olympia has been pursuing the claim under the Bond (*see* Condition E [Right of Action by Assured or Institution], ¶ 2 [Institution]). Fannie Mae's rights, therefore, are totally derivative of Olympia's (*see Associates Comm. Corp. v Nationwide Mut. Ins. Co.*, 298 AD2d 537, 538 [2d Dept 2002] ["It is well settled that a 'loss payee' stands in the shoes of its insured and may only recover if the insured can"]; *Wometco Home Theatre, Inc. v Lumbermens Mut. Cas. Co.*, 97 AD2d 715, 716 [1st Dept 1983] ["In the absence of a provision that the insurance policy shall not be invalidated by any act or neglect of the insured, a 'loss payee' is not itself an insured under

the policy; it is merely the designated person to whom the loss is to be paid"], *affd on opinion below* 62 NY2d 614 [1984]; *see also Sun Ins. Co. of New York v Hercules Sec. Unlimited, Inc.*, 195 AD2d 24, 30-31 [2d Dept 1993] [granting summary judgment to plaintiff insurers where the fraud preceded the inception of the fidelity bond, notwithstanding the fact that the failure to pay the claim would harm innocent customers of the insured; the status of the insured's customers as traditional "loss payees" rendered them subject to all defenses which the insurer could assert against the insured]).

Lastly, Insuring Clause B1 is not pertinent at this stage of the case. This clause covered *Olympia's* liability for theft of Fannie Mae's money or sale or double pledging of its collateral, but did not make Fannie Mae a direct beneficiary of the Bond as an additional insured. Thus, Fannie Mae may be indemnified as a loss payee only if Olympia may recover under the Bond. Accordingly, determination of Fannie Mae's rights, if any, must await trial.

Conclusion

The Insurers' motion for summary judgment is denied.

That branch of Olympia's cross motion for partial summary judgment is denied and the remainder of its cross motion is dismissed as moot.

The foregoing constitutes the decision and order of the court.

ENTER,

J. S. C. HON. DAVID I. SCHMIDT