

**Leading Ins. Group Ins. Co., Ltd. v Friedman LLP**

2020 NY Slip Op 30689(U)

February 28, 2020

Supreme Court, New York County

Docket Number: 651049/2015

Judge: Saliann Scarpulla

Cases posted with a "30000" identifier, i.e., 2013 NY Slip Op 30001(U), are republished from various New York State and local government sources, including the New York State Unified Court System's eCourts Service.

This opinion is uncorrected and not selected for official publication.

SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART IAS MOTION 39EFM

-----X

LEADING INSURANCE GROUP INSURANCE  
COMPANY, LTD. (U.S. BRANCH), LEADING  
INSURANCE SERVICES, INC.,

INDEX NO. 651049/2015

MOTION DATE 10/24/2019

Plaintiffs,

MOTION SEQ. NO. 003

- v -

FRIEDMAN LLP

**DECISION + ORDER ON  
MOTION**

Defendant.

-----X

HON. SALIANN SCARPULLA:

The following e-filed documents, listed by NYSCEF document number (Motion 003) 93, 94, 95, 96, 97, 98, 99, 100, 101, 102, 103, 104, 105, 106, 107, 108, 109, 110, 111, 112, 113, 114, 115, 116, 117, 118, 119, 120, 121, 122, 123, 124, 125, 126, 127, 128, 129, 130, 131, 132, 133, 134, 135, 136, 137, 138, 139, 140, 141, 142, 143, 144, 145, 146, 147, 148, 149, 150, 151, 152, 153, 154, 155, 156, 157, 158, 159, 160, 161, 162, 163, 164, 165, 166, 167, 168, 169, 170, 171, 172, 173, 174, 175, 176, 177, 178, 179, 180, 181, 182, 183, 184, 185, 186, 187, 188, 189, 190, 191, 192, 193, 194, 195, 196, 197, 198, 199, 211, 212, 213, 214, 215, 216, 217, 218, 219, 220, 221, 222, 223, 224, 225, 226, 232, 234, 240, 243, 245

were read on this motion to/for JUDGMENT - SUMMARY.

Upon the foregoing documents, it is

This accounting malpractice action arises out of auditing work performed by defendant Friedman LLP (“Friedman”) for plaintiffs Leading Insurance Group Insurance Company, Ltd. (U.S. Branch) (“LIGUSB”) and Leading Insurance Services, Inc. (“LIS”) (together, “LIG”). Friedman moves, pursuant to CPLR 3212, for summary judgment dismissing the complaint.

## Background

LIGUSB is an “alien” insurance company licensed to sell property and casualty insurance in New York, and LIS serves as LIGUSB’s manager.<sup>1</sup> The New York State Department of Financial Services (“DFS”) is the agency charged with regulating the insurance industry in the state.

In 2012, LIG retained Friedman to audit its financial statement for the year ending December 31, 2012, which LIG was required by statute to submit to DFS each year. Friedman retained Actuarial Risk Consultants, LLC (“ARC”)<sup>2</sup> to assist in performing the audit. In an engagement letter dated October 24, 2012, Friedman agreed to “perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the entity or to acts by management or employees acting on behalf of the entity” (NYSCEF Doc. No. 111 at p. 2). Friedman released an independent auditor’s report dated May 31, 2013 (the “Report”), in which it concluded that LIG’s “financial statements ... present fairly, in all material respects, the admitted assets, liabilities and

---

<sup>1</sup> Insurance Law § 107 (5) defines an “alien insurer” as “any insurer incorporated or organized under the laws of any foreign nation, or of any province or territory not included under the definition of foreign insurer.”

<sup>2</sup> The Court previously dismissed all causes of action against ARC and it is no longer a defendant in the action.

surplus ... as of December 31, 2012” (NYSCEF Doc. No. 112 at p. 2). The Report also stated:

Loss reserve amounts are based on actuarial estimates and judgments using data currently available. Reserve amounts and the underlying factors and assumptions are regularly analyzed and adjusted to reflect new information. Although the reserves are deemed adequate to cover all probable claims, there is a reasonable possibility that adverse development from the prior accident years could occur in the future.

The Report at p.24. LIG continued to use Friedman’s services through April 2014.

For the year ending December 31, 2013, LIG reported a statutory trusteed surplus deficiency and a risk-based capital ratio (RBC) of 18.9% (NYSCEF Doc No. 95, ¶¶ 79-80), which triggered a “Mandatory Control Level event” and prompted DFS to take regulatory action (*id.* at ¶ 81; NYSCEF Doc No. 126 at p. 1).

SGRisk LLC (“SGRisk”), a consultant LIG had retained to conduct a peer review and assess its loss and loss expense reserves, issued a draft report stating that LIG’s net carried reserves as of December 31, 2013 was deficient by approximately \$40 million (NYSCEF Doc. No. 95 at ¶¶ 66-70). DFS issued an order dated March 7, 2014 (the “March Order”) prohibiting LIG from (1) issuing new policies while an impairment of its trusteed surplus existed and (2) writing or renewing any insurance business (NYSCEF Doc. No. 126 at 1-2). The March Order noted a trusteed surplus deficiency of \$15.6 million (*id.* at 1). After LIG’s parent company provided LIG with a \$45 million capital

contribution within two days of the March Order<sup>3</sup> (NYSCEF Doc. No. 95 at ¶ 83), DFS lifted the restriction imposed on LIG's renewal business (*id.* at ¶ 84).

Additionally, while performing a market conduct investigation into LIG in 2013, DFS discovered a series of violations of the Insurance Law or its implementing regulations regarding the pricing of LIG's policies, which DFS shared with LIG on October 28, 2013 (NYSCEF Doc No. 135 at p.1). In May 2014, DFS and LIG executed a stipulation in which LIG admitted to having violated Insurance Department Regulations (11 NYCRR) §§ 160.2 (c), 161.7 (c), and 161.8 (e), (g), and (i), and agreed to pay a \$250,000 civil penalty ( NYSCEF Doc. No. 127 at p. 2-3).

LIG then commenced this action against Friedman and ARC, alleging causes of action for: (1) professional malpractice against Friedman and ARC; (2) breach of contract against Friedman; (3) negligent misrepresentation against Friedman; (4) breach of fiduciary duty against Friedman; (5) gross negligence against Friedman; and (6) unjust enrichment against Friedman and ARC. All causes of action except for professional malpractice as against Friedman only were dismissed in a previous motion.

With respect to the accounting malpractice claim, plaintiff alleges that Friedman's failure to detect deficiencies in LIG's loss reserves, which two independent actuarial firms had determined were inadequate, led DFS to initiate regulatory action against it. The complaint alleges that "[h]ad LIG been so informed by Defendants ... it would have

---

<sup>3</sup> LIG alleges that its parent company provided it with \$140 million in capital contributions between March 2014 and March 2015.

been able to make appropriate adjustments and take necessary corrective measures to avoid the regulation action and related damages that it has been forced to incur” (NYSCEF Doc. No. 97 at ¶ 8).

Friedman now moves for summary judgment, arguing that the accounting malpractice claim should be dismissed because LIG cannot demonstrate that Friedman’s alleged negligence proximately caused LIG injuries. Although the complaint pleads that LIG’s failure to identify the deficiencies in its reserves caused DFS to initiate regulatory action, Friedman asserts that this allegation is belied by the conclusions of LIG’s own experts, Richard H. Hershman (“Hershman”) and Gregory V. Serio (“Serio”). Friedman argues that both Hershman and Serio conclude that, if Friedman had identified the deficiencies in its reserves during the audit, the DFS regulatory action would have occurred months earlier.

Moreover, Friedman maintains that LIG’s damages are wholly speculative, based on unspecified acts that DFS (and LIG) would have taken had Friedman accurately reported the loss reserves deficiency. Friedman argues that LIG cannot demonstrate a causal connection between Friedman’s conduct and its damages. Friedman also argues that LIG’s experts contradict LIG’s theory of the case because the experts opined that DFS’s regulatory action was inevitable, and therefore Friedman is not the cause of LIG’s damages. Lastly, Friedman argues that LIG cannot show actual or ascertainable damages caused by Friedman’s alleged negligence. To the extent LIG seeks lost income as

consequential damages, Friedman argues that LIG cannot recover this category of damages was not contemplated by the parties.

In opposition, LIG argues that the professional malpractice claim is based on Friedman's negligence in failing accurately to report LIG's loss reserves in May 2013, forestalling LIG from taking corrective action until February 2014. LIG posits that it seeks to recover damages incurred during this nine-month period, which Hershman calculates at \$50,721,087 (NYSCEF Doc. No. 222 at ¶ 151). Further, LIG claims that its damages are not speculative because Hershman based his opinion upon LIG's "actual historical results" (*id.* at ¶ 149). As to the issue of proximate cause, LIG claims that Friedman has not submitted an expert opinion refuting Hershman's calculations. LIG further argues that the issue of proximate cause and whether LIG's claimed damages were reasonably foreseeable are best left to a jury to determine.<sup>4</sup>

## Discussion

It is well settled that the movant on a summary judgment motion "must make a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to eliminate any material issues of fact from the case." *Winegrad v New York Univ. Med. Ctr.*, 64 NY2d 851, 853 (1985). To prevail on a claim for accounting malpractice, the plaintiff "must show that there was a departure from the accepted

---

<sup>4</sup> LIG also maintains that many of the documents submitted in support of Friedman's motion are not admissible, and that, for this reason, I should deny Friedman's summary judgment motion. I have considered LIG's arguments on admissibility of documents and find them unavailing.

standards of practice and that the departure was a proximate cause of the injury.” *KBL, LLP v Community Counseling & Mediation Servs.*, 123 AD3d 488, 488 (1st Dept 2014).

Proximate cause requires proof “beyond the point of speculation and conjecture a causal connection between [plaintiff’s] loss and the defendant’s actions.” *Herbert H. Post & Co. v Sidney Bitterman, Inc.*, 219 AD2d 214, 224 (1st Dept 1996). A plaintiff may establish proximate cause by showing (1) that it “affirmatively acted on the defendant’s alleged erroneous [accounting documents] and assurances,” or (2) that the plaintiff would have mitigated its damages “had the documents been correctly prepared.” *Pennington v D’Ippolito*, 2019 WL 6498346 at p. 5 (S.D.N.Y. 2019).

In its summary judgment motion, Friedman alleges that LIG’s distressed financial condition stemmed from its own poor business practices and not from Friedman’s alleged erroneous audit. However, LIG’s expert, Serio, opined that LIG’s distressed financial condition should have been apparent at the time Friedman performed its audit (NYSCEF Doc. No. 194, ¶ 42).

Likewise, Hershman opined that LIG’s goal of increasing its premiums should have alerted Friedman “that there may be a higher risk of material misstatement of reserves” (NYSCEF Doc. No. 192 at ¶ 126). Hershman stated that insurers “rely on their auditors as a check to ensure reserves are reasonably stated and that determining the adequacy of reserves is critical for an auditor” (*id.* at ¶ 23). He further stated that “a significant understatement of reserves will result in many financial and regulatory issues” (*id.*).

According to the expert testimony submitted by LIG, a proper audit would have, at a minimum, mitigated the damages that LIG suffered because of its insufficient reserves and inadequate business practices. This expert testimony is sufficient to create an issue of fact as to whether Friedman's audit caused LIG some measure of damages. Further, whether LIG was operating at a loss prior to Friedman's rendering of its Report does not nullify Friedman's alleged failure to correctly perform its audit.

Friedman also takes issue with the fact that LIG's experts' theories as to damages do not precisely comport to the allegations of damages in the complaint and in responses to discovery demands. It is true that, in the complaint, LIG alleges that, had Friedman performed its audit properly, "LIG would then have taken appropriate and/or necessary corrective measures prior to filing [the] 2012 audited Statutory Financial Statements with the NYDFS and the resulting damages that LIG has been forced to incur would have been avoided." In contrast, LIG's experts do not opine that LIG would have avoided NYDFS action completely had the audit been properly performed. Rather, Friedman's experts opine that LIG's damages stem, in part, from the amount of time in between when the NYDFS would have acted had a proper audit been conducted, and when the NYDFS actually did act.

While LIG's expert opinions as to damages do not track precisely LIG's original allegations in the complaint as to damages, the expert opinions do not assert a completely different theory of damages. Thus, in its interrogatory answer on damages, LIG stated that LIG's "preliminary damage computation is also based on economic damages related

to its loss of business income in connection with regulatory restrictions.” NYSCEF Doc. No. 99, p. 21. LIG’s expert calculation of damages is based, in part, on LIG’s loss of income between the time LIG’s expert opines NYDFS would have acted and the time it did act. *See* NYSCEF Doc. No. 192, Hershman Report, pages 50-52.<sup>5</sup>

Further, the Court of Appeals has recently held that, “[a]lthough the plaintiff’s deposition testimony partially contradicted the factual conclusions reached by her expert witnesses, the expert opinions were based upon other record evidence and were neither speculative nor conclusory. Insofar as plaintiff raised genuine issues of fact on the element of causation, summary judgment should not have been granted on that ground” (*Salinas v World Houseware Producing Co.*, 34 NY3d 925, 926 [2019]). Likewise, here, even though LIG’s expert opinions did not precisely match LIG’s allegations concerning loss causation, LIG’s experts’ opinions were based on record evidence and were not conclusory. Any alleged discrepancy between plaintiff’s allegations concerning damages and its expert opinions as to damages is an issue for trial, not a sufficient ground upon which to grant Friedman summary judgment.

Next, Friedman argues that LIG’s damages are impermissibly speculative because they are predicated upon the NYDFS’s actions, which was outside either LIG’s or Friedman’s control. However, the First Department has upheld a theory of damages based

---

<sup>5</sup> I note that LIG’s expert reports were prepared in 2018, and Friedman has had ample time to digest and rebut those expert reports. Friedman has deposed LIG’s experts and submitted its own expert reports disputing liability and damages. Thus, LIG cannot claim prejudice or surprise as to LIG’s calculation of damages.

upon adverse government action and deepening financial distress allegedly caused by failure properly to reflect a company's true financial picture. *See Corcoran v Hall & Co.* (149 AD2d 165 [1st Dept 1989]). *Corcoran* involved the liquidation of an insurer by the Superintendent of Insurance of the State of New York. One of the defendants in that action was the insurer's former auditor. The Superintendent claimed that the auditor allegedly concealed the true financial condition of the insurer from both the insurer and the Superintendent, which led the insurer to assume additional risks that increased its exposure to its creditors (*id.* at 175).

The First Department approved a theory of damages based on the auditor's failure to apprise the plaintiff of the insurer's "true financial condition," thus preventing the insurer and the Superintendent "from taking corrective measures, through rehabilitation, which may have prevented the \$140,000,000 insolvency" (*id.* at 175-176). Similarly, while Friedman alleges that it is speculative to assume that LIG would have undertaken any action, or that the NYDFS would have acted sooner, had the audit been correctly performed, Friedman has not established as a matter of law that LIG's theory of damages is impermissibly speculative.

Next, to rebut LIG's theory on causation, Friedman relies on testimony from two of LIG's former vice presidents, Kevin Leong ("Leong") and former chief financial officer, Young Namgung ("Namgung"). Friedman argues that their testimony shows that LIG did not rely on Friedman's conclusions in the Report. Leong testified that he could not recall if he reviewed the Report upon receiving it or if LIG took any action based on

it (NYSCEF Doc. No. 186, Leong tr. at p. 246-248). Namgung testified that he could not recall whether LIG took any action based on the Report (NYSCEF Doc. No. 187, Namgung tr. at p.162, 167). Although their testimony reflects the absence of a specific affirmative act, proximate cause may also be established where the plaintiff could have mitigated its damages had the audit been correctly performed (*see Pennington*, 2019 WL 6498346 at p.13-14 [S.D.N.Y. 2019]), which is what LIG has alleged.

Friedman also argues that the terms of the parties' engagement letter relieves it of liability. The engagement letter places the burden of establishing and maintaining internal controls upon LIG, but Friedman also agreed it would evaluate the appropriateness of LIG's accounting policies and the reasonableness of its accounting estimates with a view of obtaining "reasonable assurance ... whether the financial statements are free of material misstatement" (NYSCEF Doc. No. 111 at p. 3). On this motion, Friedman has not argued that it complied with the foregoing in accordance with accepted accounting practices or that the Report was free of a material misstatement. Therefore, the engagement letter is insufficient to eliminate fact issues regarding Friedman's alleged negligence.

Lastly, Friedman states that LIG's risky business practices predated Friedman's audit, and therefore, LIG cannot conclusively establish that Friedman proximately caused it injury. Although a plaintiff's damages must be "directly traceable" to the defendant's conduct (*Kenford Co. v County of Erie*, 67 NY2d 257, 261 [1986]), Friedman's argument addresses the measure of LIG's damages and whether those damages are recoverable, not

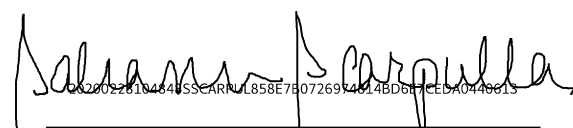
whether LIG sustained harm from Friedman’s alleged negligence (*see e.g. C.P. Ward, Inc. v. Deloitte & Touche LLP*, 74 AD3d at 183) (Court held that defendants failed to show that their “alleged failure to detect and report the errors and irregularities in the financial statements was not a proximate cause of the damages allegedly sustained by plaintiffs”); Here, although LIG may have had underlying financial issues predating the audit, that fact does not conclusively establish that Friedman’s alleged negligence was not a proximate cause of at least some of LIG’s damages.

For all of the foregoing reasons, I find that there are material issues of fact concerning proximate cause and I therefore deny Friedman LLP’s motion for summary judgment.

In accordance with the foregoing, it is

ORDERED that defendant Friedman LLP’s motion for summary judgment dismissing the complaint against it is denied.

This constitutes the decision and order of the Court.

<u>2/28/20</u> <b>DATE</b>			 <b>SALIANN SCARPULLA, J.S.C.</b>
CHECK ONE:	<input type="checkbox"/> CASE DISPOSED	<input checked="" type="checkbox"/> DENIED	<input checked="" type="checkbox"/> NON-FINAL DISPOSITION
APPLICATION:	<input type="checkbox"/> GRANTED		<input type="checkbox"/> GRANTED IN PART
CHECK IF APPROPRIATE:	<input type="checkbox"/> SETTLE ORDER		<input type="checkbox"/> OTHER
	<input type="checkbox"/> INCLUDES TRANSFER/REASSIGN		<input type="checkbox"/> FIDUCIARY APPOINTMENT
			<input type="checkbox"/> REFERENCE