

Insurer Has No Duty to Defend Where Complaint Against Policyholder Alleges Employee Dishonesty, Invoking the Dishonesty Exclusion in an E&O Policy

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The United States Court of Appeals for the First Circuit affirmed a district court's ruling that an insurer has no duty to defend where the allegations against the insured alleged misconduct excluded under the E&O policy's dishonesty exclusion. *New Fed Mortgage Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 2008 WL 4399009 (1st Cir. 2008).

The policyholder was a residential mortgage originator and broker whose business included providing lenders with information, including credit reports, on mortgage applicants. Once the mortgage loans were approved, the lenders would often repackage the loans and sell them to investors. One employee allegedly falsified a number of credit reports of mortgage applicants by providing the lenders with inflated credit scores for the applicants. When one lender learned of the fraudulent applications, it was forced to repurchase certain loans from investors and to sell the loans at a substantial loss. It sued the policyholder for indemnity, and the policyholder sought coverage under its E&O policy.

The E&O policy excluded from coverage "any Claim . . . alleging fraud, dishonesty, or criminal acts or omissions on the part of the Insured." The policy defined "Insured" to include the policyholder and its employees. The insurer denied coverage under the E&O policy under this dishonesty exclusion because the lender's claim against the policyholder alleged employee dishonesty.

The First Circuit held that the insurer had no duty to defend or indemnify the policyholder because the claim for which coverage was sought fell squarely within the policy's dishonesty exclusion. "Where the third party's allegations against the insured 'lie expressly outside the policy coverage and its purpose, the insurer is relieved of the duty to investigate or defend the claimant.'" Therefore, the court held that the insurer "has no duty to defend because [the lender] alleged misconduct by [the policyholder] that is plainly excluded from coverage."