

Mortgage Repurchase Claims Exclusion Not Contrary to Reasonable Expectations of Insured Mortgage Broker

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The United States District Court for the Middle District of Pennsylvania has granted judgment in favor of a professional liability insurer in connection with several claims filed against an insured mortgage broker, rejecting the insured's argument that an exclusion for claims arising out of the insured's failure to repurchase loans defeated the insured's "reasonable expectations" under Pennsylvania law. *Nations First Mortgage, LLC v. Tudor Ins. Co.*, 2009 WL 3182967 (M.D. Pa. Sept. 30, 2009). The court also held that other claims were not timely noticed to the insurer, that the policy's "fraud exclusion" barred coverage for the remaining claim, and that the insured had constructive knowledge of the policy's terms because the policy had been delivered to the insured's broker.

In one action, a mortgage lender sought to compel the insured to repurchase mortgages it had sold to the lender that allegedly did not satisfy the lender's criteria. The insured admitted that the policy's exclusion "for any claim based upon or arising out of: . . . the Insured's failure to repurchase any loan(s)," if enforced, would bar coverage for the mortgage lender's action. The insured argued, however, that this exclusion defeated its reasonable expectations of coverage and was therefore invalid. The insured cited the statement in its application for the policy that it intended for the policy to cover "[e]rror[s] in application processing which will cause bank to require buyback of mortgage." The court rejected this argument, citing Pennsylvania law that the reasonable expectations doctrine applies where an insurer has misled an insured to believe that a policy provides coverage. Here, the court found that the relevant endorsement was identified in the declarations page accompanying the policy and that the insured's agent was given the endorsement long before the coverage year in question. The court found no evidence to support the insured's claim that the insurer agreed to the additional request for coverage or orally represented that the request would be covered. The court concluded that, "although the insurer may be criticized for not having highlighted the significance of the endorsement, there is no evidentiary foundation for a conclusion that it misled [the insured] into believing it had coverage when it was excluded." Accordingly, the exclusion was not invalid under the reasonable expectations doctrine, and the insurer had no duty to indemnify or defend in connection with the lender's action.

The court then addressed a group of actions filed by home buyers alleging that the insured engaged in predatory lending practices. The court granted judgment for the insurer in connection with the insured's claim for coverage for these actions on the basis that notice of the actions was not timely provided to the insurer. The insured tendered notice of the claims, at the earliest, nearly a month after the expiration of the claims-made policy period. In concluding that late notice precluded coverage for the claims, the court first rejected the insured's argument that it had no knowledge of the policy's notice requirement because it never received a copy of the policy. It concluded that evidence that the policy was delivered to the insured's insurance broker, acting as an agent for the insured, was sufficient to impute knowledge of the policy to the policyholder. The court also rejected the insured's argument that the policy's notice provisions were ambiguous because the policy required notice both within the policy period and "as soon as practicable." The court determined that the two provisions were not in conflict and that, because the policy provided "claims made" coverage, the notice provisions would be strictly construed, thereby precluding coverage for the late-noticed actions. Finally, the court considered the insured's claim for coverage in connection with an action filed by the state alleging unfair trade practices and violations of the state's consumer protection law. The court held that the insurer had no duty to indemnify or defend in connection with the state's action because the policy's "fraud" exclusion barred coverage for "any loss in connection with or arising out of or in any way involving . . . [a]ny dishonest, fraudulent, criminal or malicious act or omission of the Insured." Because the state's action alleged deliberate and willful fraudulent conduct, rather than negligent acts, errors or omissions, the court found that coverage for the action was precluded.