

# Dishonesty Exclusion Bars Coverage for Lawsuits Arising out of Insured's Admitted Participation in Mortgage Fraud Scheme

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The United States District Court for the District of Connecticut, applying Connecticut law, has ruled that the dishonesty exclusion in a lawyers' professional liability policy bars coverage for lawsuits arising out of the insured's participation in a mortgage fraud scheme. *Cont'l Cas. Co. v. Kriz*, No. 3:09-cv-00835 (PCD) (D. Conn. Mar. 30, 2011). Wiley Rein LLP represented the insurer in this matter.

The insurer issued a lawyers' professional liability policy to the insured that contained a dishonesty exclusion barring coverage for claims arising out of the insured's dishonest, fraudulent or criminal acts or omissions, if such acts or omissions are determined by a court ruling or legal admission. In 2008, the insured was named as a defendant in several lawsuits in which title companies alleged that the insured, when acting as a closing attorney for property sales and re-financings, improperly failed to disburse loan proceeds entrusted to him to pay off prior liens or mortgages. The insurer agreed to provide the insured with a defense in these lawsuits subject to a reservation of rights.

The insured subsequently pled guilty to charges that he conspired to defraud clients, title companies and others from about January 2005 through March 2008. As part of the scheme, he admitted to retaining his clients' mortgage payoff payments by falsely representing that he had paid off the mortgages. The insured also admitted that he had defrauded a title company by sending it a title insurance policy that represented that a refinancing mortgage was the primary lien on a property, when in fact he had not paid off the first mortgage. After learning of the guilty plea, the insurer filed a declaratory judgment action seeking a ruling that it was entitled to deny coverage based on the dishonesty exclusion, among other policy provisions.

The court granted summary judgment for the insurer based on the dishonesty exclusion. In doing so, the court found that the underlying claims arose out of the criminal conspiracy to which the insured pled guilty. It noted that the criminal conduct described in the insured's guilty plea was "strikingly similar" to the conduct alleged in the underlying lawsuits, and that documents produced by the title company in the coverage litigation indicated that it also recognized the connection between the conduct at issue in the civil lawsuits and the criminal matter.

The court rejected the insured's argument that the insurer was estopped from relying on the dishonesty exclusion because the carrier had breached its duty to defend. The court noted that the insurer had continued to provide a defense in the underlying lawsuits until it obtained a default judgment against the insured in the coverage litigation. The court also rejected an argument that an innocent insured exception to the dishonesty exclusion applied, noting that only the insured was named as a defendant in the underlying lawsuits and had sought coverage under the policy. The court therefore concluded that the hypothetical scenario in which an employee of the insured might also be named as a defendant and seek coverage did not raise an issue of material fact as to whether the innocent insured exception applied.