

Criminal Fraud Conviction Triggers "In Fact" Exclusions

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The United States District Court for the Eastern District of Virginia has held that a criminal conviction satisfied the "in fact" requirement in two policy exclusions contained in a directors and officers liability policy and allowed an insurer to cease advancement of defense costs for a criminal proceeding. *Farkas v. Nat'l Union Fire Ins. Co.*, 2011 WL 2838167 (E.D. Va. July 14, 2011).

The insured was the owner and majority shareholder of a mortgage company and was indicted for federal bank, wire, and securities fraud. The insurer agreed to advance defense costs for the criminal proceeding while reserving rights under policy exclusions that barred coverage for claims "arising out of, based upon or attributable to the gaining in fact of any profit or advantage to which an Insured was not legally entitled" and for claims "arising out of, based upon or attributable to the committing in fact of any criminal, fraudulent or dishonest act, or any willful violation of any statute, rule or law." After a jury trial, the insured was found guilty of fourteen fraud and conspiracy counts, and the insurer informed the insured that it would no longer advance defense costs for the criminal proceeding because the convictions triggered the exclusions. The insured filed suit against the insurer and sought a preliminary injunction requiring the insurer to advance defense costs for the appeal of the criminal proceeding.

The court denied the insured's request for a preliminary injunction. The court held that the insured was not likely to succeed on the merits because the "in fact" requirement in the exclusions was satisfied by the verdict in the criminal trial. The court held that the "in fact" requirement was satisfied by "some pertinent factual finding" that the insured's behavior fell within the exclusion." According to the court, the jury's verdict, which required a finding of fraud by the evidentiary standard of beyond a reasonable doubt, clearly constituted "some pertinent factual finding" of fraudulent conduct. The court rejected the insured's contention that the insurer was required to advance defense costs on appeal because the policy provided that defense costs would be provided "prior to [the claim's] final disposition." The court held that the insurer was only required to pay defense costs if the claim were covered by the policy. The court also held that denying the injunction would not irreparably harm the insured because his criminal appeal would be handled by a federal public defender or court-appointed counsel and public policy considerations weighed against requiring an insurer to provide coverage for an excluded claim because such a ruling would increase the cost of insurance and make insurers more hesitant to offer insurance to corporate directors and officers.