

Suit for Misuse of Investment Funds Does Not Allege Act in Performance of “Mortgage Broker Services” Within Definition of “Insured Services”

November 2013

The United States District Court for the Northern District of Texas has held that underlying claims that the insureds misused investment funds intended for the purchase of nonperforming mortgages did not allege negligent acts, errors, or omissions in performing “mortgage broker services” within the policy's definition of “Insured Services.” *Axis Surplus Ins. Co. v. Halo Asset Mgmt., LLC*, 2013 WL 5416268 (N.D. Tex. Sept. 27, 2013).

Between December 2010 and August 2011, the claimants invested approximately \$5 million in a plan to purchase nonperforming mortgage notes and repackage and restructure the notes into performing loans. A number of third parties proposed to repurchase and restructure the mortgages, and the insureds agreed to process and service the mortgages. Alleging that their funds never were used to purchase mortgages, the investors filed suit against the third parties and insureds, asserting causes of action for, among others, fraud, breach of fiduciary duty, negligence, breach of contract, unjust enrichment, and violation of the Texas Securities Act. The insurer denied coverage and sought a declaration that it had no duty to defend or indemnify its insureds.

Ruling on the insurer's motion for summary judgment, the court held that the insurer did not have a duty to defend the suit under Texas's eight-corners rule. Examining the allegations of the underlying complaint and the policy's insuring agreement, the court held that the alleged misuse of invested funds did not involve “mortgage broker services,” an undefined term within the policy's definition of “Insured Services.” In so holding, the court rejected the insureds' reliance on “generic and overly broad definitions . . . isolated from the mortgage context.” The court instead relied on *Black's Law Dictionary's* definition of “mortgage broker,” which states that “[a] mortgage broker does not originate or service mortgage loans.” This, according to the court, was the role the insureds allegedly had agreed to play. The court further noted that “[t]he fact that the proposed investment scheme was supposed to involve mortgages does not overshadow the fact that the allegations ultimately stem from fraud and misappropriation of funds.”

The court denied the insurer's motion with respect to the duty to indemnify. Holding that "an insurer may have a duty to indemnify its insured even if the duty to defend never arises," *D.R. Horton-Texas, Ltd. v. Markel International Insurance Co.*, 300 S.W.3d 740, 744 (Tex. 2009), the court noted that liability had not yet been established in the underlying action.