

ALERT

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

March 31, 2011

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.

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 federal charges that he conspired to defraud clients, title companies and others from about January 2005 through March 2008. As part of the scheme, he and his co-conspirators retained 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 it learned of the guilty plea, the insurer filed

Practice Areas

D&O and Financial Institution Liability
E&O for Lawyers, Accountants and Other Professionals
Insurance
Professional Liability Defense

a declaratory judgment action for a ruling that it was entitled to deny coverage based on the dishonesty exclusion and a prior knowledge condition in the policy's insuring agreement.

The court granted summary judgment for the insurer based on the dishonesty exclusion, and did not address whether the prior knowledge provision also precluded coverage. In particular, 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 an argument that the insurer was estopped from arguing that the dishonesty exclusion barred coverage because it 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. In addition, the court 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.