

ALERT

"In Fact" Requirement Triggered by Jury's Guilty Verdict

April 23, 2012

Applying Illinois and Florida law, the United States District Court for the Eastern District of Virginia has held that a jury's guilty verdict in a criminal proceeding triggers the "in fact" element of a D&O policy's dishonesty and personal profit exclusions, allowing the insurer unilaterally to cease advancing defense costs. *Farkas v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa.*, 2012 WL 966577 (E.D. Va. Mar. 21, 2012).

The insured, the chairman of a bankrupt mortgage corporation, was indicted on various criminal counts for bank, wire and securities fraud. The mortgage corporation's D&O/private company insurer agreed that the criminal proceeding constituted a claim under the policy, but reserved its right to limit or deny coverage based on certain policy exclusions. Pursuant to an order of the bankruptcy court, the parties agreed that the insurer could advance up to \$1 million for the chairman's defense costs. Shortly after the chairman's criminal trial began, the insurer advised defense counsel that his invoices had exceeded \$1 million and that the carrier would not advance funds in excess of \$1 million without the bankruptcy court's approval. While awaiting a bankruptcy court determination, the jury found the chairman guilty on all counts. The insurer informed the chairman that the jury's verdict triggered the "in fact" element of the policy's dishonesty and personal profits exclusions, such that it would no longer advance defense costs.

In the ensuing coverage dispute, the court first held that the jury's verdict clearly triggered the "in fact" requirement of the personal profit and dishonesty exclusions, rejecting the chairman's argument that the phrase was ambiguous and holding that the insurer could properly refuse to advance further defense costs without first

Practice Areas

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

obtaining a declaratory judgment that the exclusions barred coverage. In light of the overwhelming evidence of his guilt, the court deemed it irrelevant that the chairman was pursuing an appeal of his conviction.

The court next rejected the insured's argument that the carrier was obligated to advance *all* defense costs incurred prior to the jury's verdict—including the defense costs in excess of \$1 million that were incurred while the parties awaited the bankruptcy court's determination—and *then* seek reimbursement on the basis that the dishonesty and personal profit exclusions barred coverage. Noting that this was not a case where the carrier had "dragged its feet before advancing costs," the court held that forcing the carrier to pay out amounts for which it could immediately seek recoupment was not appropriate either under the terms of the policy or as a practical matter. Finally, the court held that the insurer's filing of a claim against the insured mortgage corporation in the bankruptcy proceeding did not preclude it from simultaneously seeking recoupment from the chairman, as any payment from the bankruptcy estate would "simply offset" the funds that could be recouped from the chairman as an individual.