

ALERT

Dishonesty Exclusion Bars Coverage for False Claims Act Lawsuit

February 14, 2014

The United States District Court for the Northern District of Illinois, applying Illinois law, has held that a dishonesty exclusion barred coverage for a lawsuit alleging violations of the False Claims Act because the lawsuit alleged that the insureds made knowingly false statements to the federal government. *Gen. Star Nat'l Ins. Co. v. Adams Valuation Corp.*, 2014 WL 479759 (N.D. Ill. Feb. 6, 2014). Also, the court held that no coverage was available because the lawsuit did not allege an act or omission in the performance of professional services and held that non-insured co-defendants were not necessary parties to the coverage litigation because they had no interest in the policy.

The former employee of a bank filed a False Claims Act lawsuit against a bank and the insured real estate appraisal firm as well as one of the insured's officers. The lawsuit alleged that the insureds engaged in a scheme with the bank and the bank's officers to defraud the Federal Deposit Insurance Corporation (the FDIC) by overstating the value of properties secured by bank loans, which decreased the bank's liability for deposit insurance assessments. The real estate appraisal firm tendered the lawsuit to its E&O insurer, and the insurer filed a declaratory judgment action seeking a determination that it had no duty to defend or indemnify the insureds.

As an initial matter, the court rejected the insureds' argument that the co-defendants in the underlying lawsuit were necessary parties to the coverage litigation. The insureds contended that 14 non-insured co-defendants were necessary parties to the coverage litigation because they could have a potential claim for contribution against the insureds. The court held that the co-defendants were not necessary parties because they were not parties to the insurance policy and

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had no legal interest in the policy as potential indemnitors.

The court held that the policy's dishonesty exclusion barred coverage for the lawsuit. The exclusion provided that "[t]his Insurance Policy does not apply to Claims: [a]rising out of a dishonest, fraudulent, criminal or malicious act or omission, or intentional misrepresentation . . . committed by, at the direction of, or with the knowledge of any Insured." The exclusion applied because, to establish civil liability under the False Claims Act, the claimant must prove that the insureds knowingly made a false statement to the government.

Although the court reasoned that it need not reach the issue, it also held that no coverage was available for the suit because it did not allege an act or omission in the performance of professional services, which included services performed as a real estate appraiser for a fee. The insured's liability, if any, would be based on its false submissions to the FDIC and not the performance of real estate appraisals.

The opinion is available [here](#).