

Exclusion for Misappropriation of Assets Bars Coverage for Claims Against Insured Law Firm

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The United States District Court for the District of Columbia has held that an exclusion for claims based on or arising out of the loss or misappropriation of assets within an insured law firm's control barred coverage for six actions arising out of the law firm's participation in an alleged fraudulent investment scheme. *Navigators Ins. Co. v. Baylor & Jackson, PLLC*, 2012 WL 3683011 (D.D.C. Aug. 28, 2012). Wiley Rein LLP represented the insurer.

Between March 2011 and January 2012, six lawsuits were filed against the law firm and/or its two partners alleging that, as part of an investment scam, the firm had failed to return and misappropriated funds deposited in the firm's escrow accounts. The firm sought coverage under its professional liability policy, and the insurer initially agreed to provide a defense under a reservation of rights. The insurer subsequently denied coverage for all of the actions and filed suit against the law firm and the two partners seeking a declaration that the actions were not covered or, alternatively, that the policy was void *ab initio* due to the firm's failure to disclose two unrelated pending legal malpractice claims in its application for the policy. The insurer also sought a money judgment for the amount it expended defending the insureds prior to its declination. The insureds failed to answer the complaint, and the plaintiffs in two of the underlying actions were permitted to intervene.

Ruling on the insurer's motions for default judgment against the insureds and for summary judgment against the intervenors, the court held that the policy's exclusion for claims "based on or arising out of the loss or destruction of or diminution in the value of any asset in the Insured's care, custody or control or out of the misappropriation of . . . any asset in the Insured's care" barred coverage for all six underlying lawsuits. The court applied the "eight corners rule" under District of Columbia law and, after examining the allegations in each of the underlying complaints, held that the plain language of the exclusion encompassed the alleged schemes and misappropriations. Finding no coverage, the court awarded the insurer a judgment for the total amount it expended in defense of the insureds. The court did not reach the insurer's alternative argument that the policy was void *ab initio*.