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ALERT

Dishonesty Exclusion Bars Claims for Legal Malpractice and Breach of Fiduciary Duty

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A federal court in Colorado, applying Colorado law, has found that a dishonesty exclusion bars coverage for legal malpractice and aiding and abetting breach of fiduciary duty claims when such claims "arise out of" acts that require proof of unlawful purpose or intent. *Hackstaff Law Group, LLC v. Hartford Casualty Insurance Co.*, 2013 WL 2557394 (D. Colo. June 11, 2013).

The insured law firm's client, a construction company, needed additional financing to complete a construction project, which it sought from a third party. As part of that transaction, the third party demanded a direct ownership interest in the underlying property. Although the construction company did not have an interest in the property, a fact of which both the insured and the third party were aware, the construction company—with the insured's assistance—executed a deed that conveyed a direct ownership interest in the property to the third party.

The third party then brought suit against the owners of the property, who in turn added the insured and the construction company to the litigation. The property owners asserted claims for civil conspiracy, aiding and abetting a breach of fiduciary duty and legal malpractice against the insured. The insured reported the lawsuit to its professional liability insurer. The insurer determined that it had no duty to defend the insured as a result of an exclusion for "'Claims' arising out of an act, error or omission, or 'personal injury' committed by the 'insured' or at the 'insured's' direction with dishonest, fraudulent, criminal, or malicious purpose or intent."

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In determining that the exclusion applied, the court first reviewed the interpretation of the terms "dishonest," "fraudulent," and "malicious." The court then reviewed the allegations against the insured, noting that the property owner asserts that even though the insured knew the construction company "had no right to convey an ownership interest, [the insured] conspired to design [a] sham transaction . . . , and did so with full knowledge of its fraudulent purpose and intended fraudulent effect." According to the court, such allegations were sufficient to trigger the exclusion. Even though legal malpractice may be established by a showing of negligence, the court determined that those allegations "flowed from" the dishonest, fraudulent or malicious conduct at issue, and thus coverage was barred.