

Insurer Not Liable for Ponzi Scheme Losses

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The United States District Court for the Northern District of California, applying California law, has granted an insurer's motion for summary judgment, finding that state insurance law precludes coverage for a policyholder's own fraudulent conduct. *Dillon v. Continental Casualty Co.*, No. 5:10-cv-05238 (N.D. Cal. Mar. 26, 2014).

In 2008, a 1031 exchange company, which held funds to shelter clients transacting in real estate from capital gains tax liability, collapsed and was unable to repay clients due to fraudulent transfers made by the company's manager and CEO. The individuals subsequently pled guilty to wire fraud, money laundering, and conspiracy in connection with the transfers. Thereafter, a victim of the Ponzi-like real estate embezzlement scheme sought coverage, as a court-appointed receiver of the insured, under four employee dishonesty policies. In relevant part, the policies covered losses "resulting from employee dishonesty" and losses to "client property" but notably only benefitted the policyholder, not third parties, and provided "no rights to any other person or organization."

In resolving the cross motions for summary judgment, the court first addressed whether the conduct at issue was insurable under California Insurance Code Section 533, which states that an insurer is "not liable for a loss caused by the wilful acts of the insured." The court found "overwhelming evidence" that the policyholders' conduct was "willful, and thus not insurable within the meaning of Section 533." The court imputed the actions of the individuals to the company because they were plainly "acting within the course of their employment and moreover were using the corporation to perpetuate their fraudulent scheme."

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Finding no exception to the state insurance law provision, the court rejected the receiver's alternate argument that Section 533 should not apply because the insurance proceeds would be paid to the client victims rather than to the wrongdoing policyholder. Instead, it found that the statute applied "even where the recovery from the insurance company would be primarily for the benefit of the victim rather than the insured." Section 533 would not permit "corrupt corporate officers to take out criminal liability insurance, willfully violate the law, and then, in the event that the wrongdoing is discovered, cover any losses to the victims with the insurance proceeds." The court reasoned that to find otherwise could create an incentive for the wrongdoer and its victims to collude in pursuit of recovery from an insurer.