USING E&O INSURANCE IN FORECLOSURE LITIGATION

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Law360, New York (December 22, 2010) -- Recently, alleged foreclosure practices ranging from "robo-signing" to the mishandling of loan modifications and foreclosures have garnered intense media attention, as well as sparked state and federal regulatory investigations, and class action and other litigation. In managing this fallout, banks and other financial services companies are expected to incur substantial costs, estimated by some at over a billion dollars. But in the process, affected companies may overlook insurance coverage as a significant means of defraying these costs.

This article analyzes the potential for coverage under companies' errors and omissions coverage, and provides guidance for maximizing it. E&O policies provide broad rights to reimbursement of a policyholder's defense costs, as well as costs for settlements and judgments, arising from the provision of "professional services." Mortgage servicing and related activities often are encompassed within the definition of "professional services." Determining the existence and extent of such coverage, however, can be quite complicated, and often varies depending on the wording of the policy and the law of the state jurisdiction that applies.

Regardless, if there is any potential for coverage, companies attempting to navigate the litigation and other risks posed by this mortgage foreclosure controversy must take immediate steps to preserve their insurance rights. For example, as outlined below, providing appropriate notice to insurers under applicable insurance policies, and properly framing settlement negotiations and settlement agreements, would be essential to maximizing the potential for coverage.

E&O insurance (also known as "professional liability" or "malpractice" insurance) generally pays for defense costs and judgments or settlements arising from negligent acts, errors or omissions made during the course of providing "professional services." Depending on the wording of the policy, it protects the company, as well as directors, officers, employees and certain others from claims by third parties.

In determining whether insurance may be available, a number of provisions of the E&O policy can come into play. For example, while under virtually all E&O policies class action litigation alleging unlawful mortgage foreclosure practices would constitute a covered "claim," whether related regulatory investigations or administrative proceedings making the same allegations also would be covered will vary from policy to policy. Some policies will expressly exclude such investigations or proceedings from the definition of a covered "claim," others will expressly include them, and still others will simply say nothing expressly either way.

Similarly, whether a policy covers claims arising from a company's mortgage foreclosure services will depend on the policy's definition of "professional services." Certain policies will define "professional services" specifically, for example as "the origination, sale, pooling and servicing of mortgage loans secured by real property," a definition which should encompass claims relating to mortgage foreclosures. Certain other policies, however, may not define "professional services" specifically, other than to refer generically to the "Insured's

Profession" — giving insurers the potential opportunity to argue that somehow foreclosure services are not covered by the policy.

Policy exclusions and limitations also are an important consideration. For example, a policy may exclude or limit coverage for claims seeking statutory penalties, fines, sanctions and punitive damages. A policy may also exclude coverage for mortgage servicing activities, which insurers likely would argue excludes coverage for foreclosure services. And almost all policies exclude intentional acts of wrongdoing, such as fraudulent or criminal acts.

The question of whether to provide notice of a particular claim to one's insurers is often a difficult decision, but one which must be reached quickly. Virtually all policies require that policyholders notify their insurers of a claim within a reasonable time — which is usually not defined. Failure to do so in certain jurisdictions can result in a total loss of coverage, regardless of whether any delay in providing notice actually prejudices the insurer. Thus, it is better to provide notice under all of your policies to ensure that you do not lose the coverage for which you paid substantial premiums.

The bottom line is that in managing the fallout from this controversy, insurance should not be overlooked. Consult with outside coverage counsel, preferably one with expertise in consumer financial services issues, to ensure that you obtain the insurance protection to which you are entitled.

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