

Coverage Barred For Mortgage Fee Dispute, 2nd Circ. Says

By Hope Patti

Law360 (February 3, 2026, 7:31 PM EST) -- Insurers for a bankrupt financial services company are not obligated to cover settlement payments and defense costs stemming from a pair of mortgage fee class actions, the Second Circuit affirmed Tuesday, finding the claims fall squarely within an exclusion for fee-related losses.

Policies issued by Lloyd's of London underwriters and seven excess insurers don't cover Residential Funding Co. LLC's liability relating to class actions claiming that certain mortgage loan fees charged by financial institutions were unlawful and that RFC, as purchaser of those loans, was derivatively liable, a three-judge panel ruled.

Claims arising from the fees paid to the financial institutions fall within the policies' fee exclusion, as expanded by a separate provision known as the deemer clause, the panel said in a nonprecedential **summary order**. The deemer clause provides that an "assured," as that term is used in the fee exclusion, includes any person or entity for whose conduct RFC is legally responsible in rendering or failing to render professional services, according to the ruling.

"By its plain language, the deemer clause includes the originating banks within the meaning of 'assured' for purposes of the fee exclusion," the panel said. Together, the fee exclusion and deemer clause bar coverage for "losses arising from claims for fees 'paid or payable by or to the assured,' 'includ[ing] any person or entity for whose conduct an assured is legally responsible in rendering or failing to render professional services.'"

According to court filings, borrowers who obtained second mortgage loans sued RFC in a consolidated class action in Pennsylvania federal court in 2001, known as the Kessler action, and a class action in Missouri state court in 2003, known as the Mitchell action. The suits alleged that the loans RFC purchased from financial institutions violated state and federal laws.

In the Mitchell action, RFC ultimately settled the class's compensatory damages claim and related attorney fees for \$15.6 million. RFC filed for Chapter 11 bankruptcy in May 2012, after which it settled the Mitchell class's punitive damages claim for \$14.5 million, court filings stated.

In the Kessler action, which was pending when RFC filed for bankruptcy, the court approved a plan that included a \$300 million settlement of the Kessler action, with \$27 million to be paid by RFC. The plan also established the ResCap Liquidating Trust to liquidate and distribute RFC's remaining assets, and assigned to the trust and class members the right to pursue claims for payment against RFC's insurers, according to court filings.

The trust and class members filed the current adversary proceeding in February 2015, seeking coverage of the settlements and defense costs.

After reviewing the parties' cross-motions for partial summary judgment, in 2019 the bankruptcy court recommended a finding that the fee exclusion does not bar the trust's and class members' claims, according to court filings. U.S. District Judge J. Paul Oetken rejected the recommendation and held in an October 2024 order that the fee exclusion does apply.

While the appeals panel found that the trust and class members waived their argument that RFC's liability does not arise from a claim for "fees" for purposes of the fee exclusion, the judges

nevertheless rejected the contention.

"As charges for labor and services related to the issuance of mortgages, these were 'fees' within the ordinary meaning of the term and thus constitute 'fees' under the fee exclusion," the panel said.

The panel further rejected the trust's and class members' argument that the deemer clause does not apply to the originating financial institutions because RFC is not "legally responsible" for the acts of those institutions.

If that were the case, the panel said it is difficult to see how RFC would be legally responsible for the fee-related misconduct of the financial institutions for the purposes of the operative coverage provision, through which the trust and class members seek to establish coverage.

"Plaintiffs attempt to avoid this tension by arguing that RFC is not derivatively liable for the wrongful acts of the originating banks but, rather, is liable for its own misconduct," the panel said. "That argument cannot be squared with the record of the underlying class actions."

The panel also held that the deemer clause applies when RFC, and not the originating financial institutions, render professional services as defined by the policies.

Counsel for excess insurer Swiss Re International SE, Thorn Rosenthal of Cahill Gordon & Reindel LLP, told Law360 on Tuesday that the court's decision was well-reasoned.

Rosenthal added that he believes the court appropriately accepted the arguments made by the insurers and rejected those of the trust and settlement members.

Representatives of the trust, and excess insurers St. Paul Mercury Insurance Co. and North American Specialty Insurance Co. declined to comment.

Representatives of the class members and other insurers did not immediately respond to requests for comment Tuesday.

U.S. Circuit Judges Reena Raggi, Susan L. Carney and Beth Robinson sat on the appeals panel for the Second Circuit.

The trust is represented by Vivek Chopra, Selena J. Linde and Alexis E. Danneman of Perkins Coie LLP.

The class members are represented by R. Frederick Walters, Karen W. Renwick, Michael B. Sichter and J. Michael Vaughan of Walters Renwick Richards & Vaughan PC and by David M. Skeens of Davis Bethune & Jones LLC.

The insurers are represented by attorneys from Lavin Rindner Duffield LLC, Wiley Rein LLP, Kaufman Dolowich LLP, Steptoe LLP, Hangley Aronchick Segal Pudlin & Schiller LLP, Kaufman Borgeest & Ryan LLP, Arnold & Porter Kaye Scholer LLP, O'Melveny & Myers LLP, DAC Beachcroft LLP and Cahill Gordon & Reindel LLP.

The case is In Re: Residential Capital LLC, case number 25-118, in the U.S. Court of Appeals for the Second Circuit.

--Editing by Bruce Goldman.