

Delaware Supreme Court Affirms that D&O Insurer Must Cover Settlement of Alleged False Claims Act Violations

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The Delaware Supreme Court recently affirmed a grant of summary judgment in favor of a mortgage lender who sought coverage for a government investigation under its management liability insurance policy, in the case *ACE American Ins. Co. v. Guaranteed Rate, Inc.*, No. 360, 2022 (Del.). We previously reported on the trial court's grant of summary judgment to the policyholder and ruling in favor of the policyholder on cross-motions for judgment on the pleadings. The Supreme Court rejected the insurers' arguments that it had no duty to defend the policyholder in connection with a \$15 million False Claims Act (FCA) investigation and settlement.

Case Background

Guaranteed Rate is a mortgage lender that participated in the government's Direct Endorsement mortgage insurance program, which made certain loans issued by Guaranteed Rate eligible for government insurance. The company purchased two insurance policies from ACE: a Management Liability Policy that provided coverage for risks associated with running and managing a business, and a Professional Liability Policy that covers risks associated with providing professional services.

In 2017, a former Guaranteed Rate employee brought a *qui tam* action against the company, alleging that Guaranteed Rate violated the FCA by falsely certifying that loans it wrote were eligible for government insurance. Following the *qui tam* lawsuit, the Department of Justice opened a civil investigation into Guaranteed Rate and issued a civil investigative demand (CID).

Guaranteed Rate submitted a claim for the CID under both ACE policies. The Management Liability Policy provided coverage for "the Loss . . . which [Guaranteed Rate] becomes legally obligated to pay by reason of a Claim . . . for any Wrongful Acts." A wrongful act was defined as "any error, misstatement, misleading statement, act, omission, neglect, or breach of duty actually or allegedly committed by" Guaranteed Rate. The Management Liability Policy also included a professional services exclusion, which excluded any claim "alleging, based upon, arising out of, or attributable to any Insured's rendering or failure to render professional services." The term "professional services" was not defined in the Management Liability Policy but was defined in the Professional Liability Policy as "mortgage banking and mortgage underwriting services and loan servicing for others for a fee." The Professional Liability Policy also excluded claims arising out of the FCA.

Guaranteed Rate sought approval from ACE to settle the False Claims Act charges, as was required by the policies. ACE failed to provide a coverage position, so Guaranteed Rate entered into a settlement for \$15 million with the government and sought reimbursement from ACE. ACE ultimately denied coverage under both

policies, citing the professional services exclusion in the Management Liability Policy and the False Claims Act exclusion in the Professional Services Policy.

The Delaware Supreme Court's Decision

Guaranteed Rate initiated a coverage action in Delaware Superior Court disputing ACE's denial and filed a motion for summary judgment on the applicability of the "professional services" exclusion in the Management Liability Policy. In opposition, ACE argued that the exclusion applied because the false certifications would not have been submitted but for Guaranteed Rate's professional services. The trial court disagreed with ACE and ruled in favor of coverage for the FCA claim, finding that certifying the records was too tenuously connected to professional services. The trial court also granted summary judgment for the policyholder on other issues that were not addressed on appeal.

Like the trial court, the Delaware Supreme Court concluded that the FCA suit was not "arising out of" Guaranteed Rate's professional services because certifying mortgages to the government is not a professional service, and therefore the Management Liability Policy provided coverage. In reaching this decision, the Court relied upon a long line of precedent from Delaware and other jurisdictions reaching similar conclusions. Most notably, this included a case where ACE had successfully argued that submitting false certifications to the federal government was separate from a professional service.

ACE raised the same argument on appeal that it did below: that the professional services exclusion applies because the false certifications were connected to Guaranteed Rate's professional services. The Court rejected this argument, finding that ACE read the exclusion too broadly. Guaranteed Rate's business, the Court reasoned, was issuing loans, not maintaining compliance with quality-control standards. Instead, certifying records to the government was "only incidentally related to professional services." The "linkage must be meaningful, not tangential."

Analysis

Although the Court acknowledged that the phrase "arising out of" is often "interpreted liberally," it drew a line in the sand that could have significance not just for future D&O coverage disputes involving professional services exclusions, but also for Delaware policyholders fighting against application of any exclusion with similarly-broad causation language. The phrase "arising out of" does not allow the insurer to exclude any tangentially related activity. Instead, as the Court explained, there must be "some meaningful linkage between the two conditions imposed in the contract."

ACE's overly broad interpretation of the phrase "arising out of" in the context of the professional services exclusion would have effectively excluded nearly every activity taken by an organization that offers professional services. After all, nearly everything the business does (including purely administrative tasks) would not occur but for the professional services that it offers. The Delaware Supreme Court was correct to reject this improper interpretation, which should further bolster arguments by Delaware companies and their directors and officers seeking to avoid broad application of exclusions in future coverage disputes.