

# The "In Fact" Exclusion of a D&O Policy Does Not Require Exhaustion of Appellate Remedies

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A recent decision of the District Court for the Eastern District of Virginia construed the "in fact" exclusion in a D&O policy and held that the exclusion applied after a jury verdict, but before the appeal of that verdict. In *Farkas v. National Union Fire Insurance Co. of Pittsburgh, PA.*, 2011 WL 2838167 (E.D. Va. July 14, 2011), National Union issued a D&O Policy to Taylor Bean & Whitaker Mortgage Corp. ("TBW"). The policy had a \$5 million limit which was eroded by defense costs. TBW filed for bankruptcy. Lee Farkas ("Farkas"), TBW's chairman and majority shareholder, was indicted for multiple counts of bank fraud, wire fraud and securities fraud. Farkas demanded coverage under TBW's D&O policy. National Union acknowledged that the indictment was a claim as defined by the policy and agreed to advance defense costs, pursuant to authorization from the bankruptcy court. National Union reserved all rights under the policy exclusions for claims arising out of "the gaining in fact of any profit or advantage to which an Insured was not entitled" or to the "committing in fact of any criminal fraudulent or dishonest act." Farkas went to trial and was convicted on all charges. National Union, having advanced approximately \$1 million for Farkas' defense, immediately notified Farkas that the verdict triggered the exclusions and that it would stop advancing defense costs. Farkas sued for a declaration that National Union was required to reimburse defense costs through the appeals process pursuant to the policy provision for funding defense costs prior to "final disposition." Farkas also sought a preliminary injunction requiring the insurer to continue to pay attorneys' fees and costs for his appeal. The court denied a preliminary injunction because Farkas failed to demonstrate that he would succeed on the merits. The court held that the "in fact" requirement becomes effective with "some pertinent factual finding" that the insured's conduct triggered the exclusion. The jury verdict "constitutes far more than some pertinent factual finding." The court also held that Farkas had failed to demonstrate irreparable harm because the appeal could be prosecuted by the Federal Public Defender or court-appointed counsel, and that the equities

avored National Union because it had already paid substantial amounts for which it would not likely be reimbursed. In addition to future costs, the court declined to require National Union to advance defense costs incurred before the verdict but not yet paid. The court stated, “it would not be in the public interest” to require an insurer to continue to provide coverage for an excluded claim because it “would increase the cost of insurance and cause insurers to be more hesitant to offer” D&O coverage. This order provides guidance for insurers regarding “in fact” exclusions and confirms that insurers have the right to immediately cease payment of defense costs when the “in fact” exclusions are triggered by “some pertinent factual finding.” For further information, please contact: [Steven J. Brodie](#) or [Jeffrey Michael Cohen](#)

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