

## New York Bankruptcy Court Rules That Fee Exclusions Do Not Bar Coverage For Class Action Suits Alleging Improper Mortgage Fees

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A New York bankruptcy court ruled that neither a Return of Fees Exclusion nor a Mortgage Fee Claim Exclusion barred coverage for class action suits alleging improper origination and closing fees charged in connection with second mortgages. *In re Residential Capital*, 2019 WL 7286880 (Bankr. S.D.N.Y. Dec. 27, 2019).

Class action plaintiffs paid origination or closing fees in connection with second mortgages or subordinate loans. Those fees were paid to the originating banks and other third parties, but not to Residential Capital Corporation, a financial services company that purchased and packaged mortgage loans for sale to investors. Residential Capital did not originate or close any of the loans at issue and did not have any contact with the class plaintiffs prior to its purchase of the loans. In the class action suits, plaintiffs alleged that Residential Capital was derivatively liable for the acts of the originating banks and directly liable based on its conduct after purchasing the loans.

Residential Capital filed for bankruptcy and then settled the class action suits. In connection with the settlements, the class plaintiffs were assigned Residential Capital's rights under its insurance policies. In the present suit, the class plaintiffs sought coverage for their settlements under combined Directors and Officers/Errors and Omissions policies. The insurers denied coverage on the basis of two exclusions. The court granted the plaintiffs' summary judgment motion, holding that coverage was not barred by the Return of Fees Exclusion or Mortgage Fee Claim Exclusion.

The Return of Fees Exclusion bars coverage for "premiums, return premiums, fees, commissions, costs, expenses or other charges paid or payable by or to the Assured." The court held that the exclusion, which expressly requires payment "to the Assured," was inapplicable because the fees were paid to the originating banks and others, and not directly to Residential Capital. The court also rejected the insurers' contention that a Deemer clause, which states that an Assured is "any person or entity for whose conduct an Assured is legally responsible," renders the Exclusion applicable to any claims that are based on fees paid to entities for whom Residential Capital was legally responsible, such as the originating banks. The court reasoned: "Even if the definition of the word 'Assured' were expanded by the Deemer Clause, the Plaintiffs' claims relating to [Residential Capital] are not covered by the exclusion because [Residential Capital] was not 'the' Assured that engaged in the excluded conduct." The court emphasized the difference between language referencing "the" Assured and "any" or "an" Assured, implying that only the latter would encompass Residential Capital.

The court also ruled that a Mortgage Fee Claim Exclusion was inapplicable. That exclusion defined Mortgage Fee Claim as “a Claim arising out of fees paid to or by a Professional Liability Assured.” Although the parties agreed that Residential Capital was a Professional Liability Assured, the court deemed it determinative that no fees were paid by or to Residential Capital.

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