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10th Cir. Rejects Warehouse Len[illegible] Claims Under Auditor's Policy

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In an action brought by two warehouse lenders, the U.S. Court of Appeals for the Tenth Circuit recently held that multiple negligent audits of the mortgage lender borrower were "interrelated" under an auditor's insurance policy and that the claim of one warehouse lender was "interrelated" with the claim of the other warehouse lender when they arose from the same audit.

A copy of the opinion in *American Southwest Mortgage Corp., et al. v. Continental Casualty Company* is available at: Link to Opinion.

Two warehouse lenders ("creditors") loaned money to a mortgage lender ("company"), and the creditors' auditor audited the company's finances each year for three years. The auditor's annual reports failed to note that the company was committing fraud. The creditors sued the auditor, and the auditor's insurer defended the suit.

The insurance policy at issue would pay up to $1 million per individual claim and up to $3 million in the aggregate. Under the policy's terms, "interrelated claims" were considered one claim and the per-claim $1 million limit applied regardless of the number of interrelated claims or claimants. The insurance policy defined "interrelated claims" as "all claims arising out of a single act or omission or arising out of interrelated acts or omissions in the rendering of professional services." Additionally, the policy described "interrelated acts or omissions" as "all acts or omissions in the rendering of professional services that are logically or causally connected by any common fact, circumstance, situation, transaction, event, advice or decision."

The trial court held that each negligently conducted audit report was not "interrelated" to each other, and that both creditors' claims on each audit in the same year were "interrelated." Both sides timely appealed.

The first question on appeal here was whether the audit reports were "interrelated acts" as defined under the insurance policy. In other words, the Tenth Circuit needed to determine whether the different audit reports were "logically or causally connected by any common fact, circumstance, situation, transaction, event, advice or decision." Furthermore, because of the use of the word "or," the Court reasoned that it could resolve this question by exclusively exploring what it means to be "logically connected."

The Tenth Circuit concluded that "logically connected" means "connected by an inevitable or predictable interrelation or sequence of events." *Berry & Murphy, P.C. v. Carolina Cas. Ins. Co.*, 586 F.3d 803, 811–12 (10th Cir. 2009). To find a logical connection between each act, the Court looked at whether the acts inevitably or predictably flowed from each other. *Id.* at 811. And what determined whether the acts flowed from one another is whether each act shared "any common fact, circumstance, situation, transaction, event, advice or decision."

Within that framework, the Tenth Circuit held that the "relevant act or omission" here was the failure to identify the absence of security interests in each of the three audit reports. Moreover, the Court held that each audit report was logically related because the same common facts and circumstances tied the recurring negligent acts together. Specifically, each audit report "flow[ed] from the other" as a result of one common circumstance: the auditor's negligence. *Berry & Murphy, P.C.*, 586 F.3d at 811. The Court explained that the common facts and circumstances underlying the recurring negligence here made it "predictable" that the auditor may make the same mistake — just as he did. *Id.*

Because the multiple audits here were logically connected by common facts and circumstances, the Tenth Circuit reversed the trial court's decision. All the audits should have been considered one "claim" under the policy, which means that the creditors could only have received up to $1 million for the individual claim.

The Tenth Circuit also concluded that the trial court did not err when it decided that the claims from both creditors stemming from the same audit were interrelated because the policy clarified as much, irrespective of the number or type of claimants.

Specifically, the policy stated that "[t]he limits of liability shown in the Declarations and subject to the provisions of this Policy is the amount we will pay as damages and claim expenses regardless of the number of you, claims made or persons or entities making claims." Thus, the Court also noted that, even if multiple parties made separate claims of liability, the policy limited the amount among all parties by treating the separate claims as "interrelated claims" if they arose from the same act.

Accordingly, the Tenth Circuit reversed the trial court in part and held that each negligent audit was interrelated. However, the Court also affirmed the trial court in part and held that one creditor's claim arising from an audit was interrelated to the other creditor's claim arising from the same audit.

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