

PAUL R. WATKINS (1899-1973)  
DANA LATHAM (1898-1974)

## LATHAM & WATKINS

ATTORNEYS AT LAW  
1001 PENNSYLVANIA AVENUE, N.W.  
SUITE 1300  
WASHINGTON, D.C. 20004-2505  
TELEPHONE (202) 637-2200  
FAX (202) 637-2201  
TLX 590775  
ELN 62793269

NEW YORK OFFICE  
885 THIRD AVENUE, SUITE 1000  
NEW YORK, NEW YORK 10022-4802  
TELEPHONE (212) 906-1200  
FAX (212) 751-4864

ORANGE COUNTY OFFICE  
650 TOWN CENTER DRIVE, SUITE 2000  
COSTA MESA, CALIFORNIA 92626-1925  
TELEPHONE (714) 540-1235  
FAX (714) 755-8290

SAN DIEGO OFFICE  
701 'B' STREET, SUITE 2100  
SAN DIEGO, CALIFORNIA 92101-8197  
TELEPHONE (619) 238-1234  
FAX (619) 696-7419

SAN FRANCISCO OFFICE  
505 MONTGOMERY STREET, SUITE 1900  
SAN FRANCISCO, CALIFORNIA 94111-2586  
TELEPHONE (415) 391-0600  
FAX (415) 395-8095

CHICAGO OFFICE  
SEARS TOWER, SUITE 5800  
CHICAGO, ILLINOIS 60606  
TELEPHONE (312) 876-7700  
FAX (312) 993-9767

LONDON OFFICE  
ONE ANGEL COURT  
LONDON EC2R 7HJ ENGLAND  
TELEPHONE 071-374 4444  
FAX 071-374 4460

LOS ANGELES OFFICE  
633 WEST FIFTH STREET, SUITE 4000  
LOS ANGELES, CALIFORNIA 90071-2007  
TELEPHONE (213) 485-1234  
FAX (213) 891-8763

December 14, 1992

The Hon. Richard L. Williams  
U.S. District Court  
Eastern District of Virginia  
P.O. Box 630  
Richmond VA 23205-0630

Dear Judge,

Thanks for sending me report of your latest affirmance from the Fourth Circuit regarding First Union Home Equity Corp. v. The Home Ins. Co.. In your letter, you stated that you were not sure whether Jeff or I worked on this case and that Maria did not have the opinion in the file. Well, since it turned out to be an A+, I will take full credit for working on this case. I am also enclosing a copy of the Findings of Fact and Conclusions of Law for your files.

I just returned back from New York, where my family threw my father a surprise 75th birthday party. It was the first time in almost six years that all of my brothers and sisters have been together in the same place. The only downside to the event was that Long Island was buffeted by a Hurricane-like Nor'easter, which made getting there exceedingly difficult. This makes three times in the last year in a half that I have chosen to travel to the site of natural disaster. You may recall my trip to Nags Head during Hurricane Bob and my trip to Newport Beach, CA during the last major earthquake there. I think someone is trying to tell me to stay at home.

Thanks also for putting in a good word for me with Harrison Wellford. Now all you have to do is get an invitation to the ancestral estates of the rest of the partners in the office, and my future will be secured here.

Give my best to Gene and to everyone in chambers. Hope to see you soon.

Very truly yours,



*U*  
*Paul*  
*Hunt*

IN THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF VIRGINIA

Richmond Division

FIRST UNION HOME EQUITY CORP.,                    )  
  )  
    Plaintiff,    )  
  )  
v.    )  
  )  
THE HOME INSURANCE COMPANY,                    )  
  )  
    Defendant.   )

File No. 91-407

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This matter came before the Court for a bench trial on January 20, 1992 on consideration of the Plaintiff's contract claim. Following trial, the Court now makes the following Findings of Fact and Conclusions of Law pursuant to Rule 52 of the Federal Rules of Civil Procedure.

I. FINDINGS OF FACT

1. Plaintiff, First Union Home Equity Corp. ("First Union"), is a North Carolina corporation with its principal place of business in Charlotte, North Carolina. First Union provides home equity loans in 25 states, including Virginia.

2. Defendant, The Home Insurance Co. ("Home"), underwrites and issues liability insurance policies, including professional liability insurance policies. Home is incorporated under the laws of the State of New Hampshire, and its principal place of business

is in Manchester, New Hampshire. It is registered to do business in Virginia.

3. First Union is the holder of a judgment against Donald G. Ferrell ("Ferrell"), formerly a licensed attorney practicing in the Commonwealth of Virginia. Ferrell is an insured of Home, pursuant to professional liability policy no. LPL-F22366 (the "Policy"). First Union brings this action to recover from Home the full amount of its judgment against Ferrell, Home's insured.

4. For the reasons stated in the Court's Memorandum Opinion and accompanying Order dated December 18, 1991, the Plaintiff was granted summary judgment on all issues except for the issue of whether Donald Ferrell's actions came within the relevant professional liability policy exclusion. Thus, it has been previously determined that:

- (a) First Union holds a valid judgment against Ferrell in the amount of \$136,713.00, plus pre- and post-judgment interest at the statutory rate.
- (b) First Union has standing to sue Home as a beneficiary of Home's contract of insurance (the Policy) with Ferrell.
- (c) The coverage provisions of the Policy, by their plain terms, establish Home's liability to First Union in this action, absent a valid defense.
- (d) The following defenses raised by Home in this action are not meritorious: lack of standing, failure to state a claim upon which relief can be granted,

misrepresentation by Ferrell in his application, and failure to mitigate damages.

4. The trial of this case focused on the sole issue of whether Home may avoid liability under the Policy exclusion which states:

I. This Policy does not apply:

(a) to any judgment or final adjudication based upon or arising out of any dishonest, deliberately fraudulent, criminal, maliciously or deliberately wrongful acts or omissions committed by the Insured. However, notwithstanding the foregoing, the Company will provide a defense for any such claims without any liability on the part of the Company to pay such sums as the Insured shall become legally obligated to pay as damages . . .

5. Ferrell's practice consisted largely of a real estate settlement practice. Ferrell and his law firm, Ferrell & Associates, maintained a client trust account at Dominion Bank. The law firm also had an operating account at Dominion Bank and had an account at Prosperity Bank, which was created to handle fees received by Ferrell and other lawyers who were associates in the firm.

6. In May of 1989, serious problems with Ferrell's trust fund account became apparent when checks drawn on the account were returned for lack of sufficient funds. Ultimately, a shortage of more than \$400,000 was found in Ferrell's trust account.

7. Immediately after the discovery of the substantial shortages in his trust account, Ferrell closed his office, executed a power of attorney to Samuel G. Kooritzky, an associate in his office, and advised the Virginia State Bar that he would no longer practice law.

8. On July 7, 1989, a Fairfax County Magistrate issued warrants for Ferrell's arrest, having found probable cause based upon several criminal complaints that had been filed by Ferrell's former clients. At about the same time, Ferrell went to West Virginia and later returned to Virginia, staying at the home of a friend. Ferrell was not located until August 15, 1989, when he was arrested by Fairfax County police officers.

9. The County of Fairfax ultimately terminated its criminal proceedings against Ferrell. Ferrell's affairs have purportedly been investigated by the United States Attorney for the Eastern District of Virginia, but, in two years, no indictment, information, or other criminal action has ever resulted from the investigation.

10. Ferrell can offer no reason for the loss of funds from his account. However, he has consistently denied any intentional wrongdoing or any intent to defraud any client, including First Union. It is clear that several other individuals besides Ferrell had signatory authority over Ferrell's trust account.

11. In the civil action against Ferrell which underlies this lawsuit, First Union initially contended in its motion for judgment that Ferrell engaged in fraud, conversion, negligence, and breach of fiduciary duty. At the outset of First Union's trial against Ferrell, the intentional tort claims were dismissed by nonsuit, and the claims for negligence and breach of fiduciary duty proceeded to the jury.

12. In April 1990, the Virginia State Bar brought a

receivership action against Ferrell, Ferrell & Associates, and Dominion Bank, styled Virginia State Bar v. Donald G. Ferrell, et al., Chancery No. 115399, in the Circuit Court of Fairfax County. Numerous claimants, including First Union, submitted claims in the receivership proceeding. On October 30, 1990, First Union filed a memorandum in the receivership proceedings in which it made the statement that Ferrell "embezzled" money from his trust account.

13. Contrary to the requirements of Virginia Disciplinary Rule 9-102, Ferrell commingled client funds with other monies in his trust account. For example, he deposited proceeds from the sale of his own house and loans from his wife into the trust account.

14. Ferrell failed to keep a disbursements ledger, a deposits ledger, and a client ledger for his trust account, contrary to the requirements of Virginia Disciplinary Rule 9-103. Instead, each case file had a receipt and disbursement ledger which were supposed to be reconciled individually. Ferrell relied on the advice of his accountant that this accounting procedure was adequate. Ferrell never reconciled his trust account.

15. Ferrell wrote many checks on his trust account that Home characterizes as suspicious. (See, e.g., Def. Ex. 5A-5E, 19-24.) Ferrell's trust account records fail to disclose the purposes of many of these checks. However, Ferrell testified that every one of these checks had a corresponding deposit. Home produced no evidence that any of these checks were connected to a transaction which was improperly handled through Ferrell's trust account.

16. Although an audit of Ferrell's trust account records would have, in all likelihood, shed some light on the reason for the shortages, Home chose not to conduct such an audit.

17. During the relevant time period, Ferrell faced abundant financial pressures from the Internal Revenue Service. In addition, he was in arrears in his alimony payments to his former wife and had incurred substantial credit card debts. In relation to his debts, Ferrell's federal income tax returns for the years 1987 and 1988 indicate modest gross incomes of \$59,235 and \$26,944, respectively.

18. Several former clients of Ferrell petitioned the Virginia State Bar's Client Security Fund and obtained relief under the rules promulgated by the Security Fund.

19. Home never subpoenaed any of the other signatories to Ferrell's trust account to testify in this action. Significantly, Home never called Miriam Q. Wood, Ferrell's office manager, nor Samuel G. Kooritzky, Ferrell's power of attorney and one of the associates in his law firm, to ask them if they knew how or why the shortages in the client trust fund occurred.

#### I. CONCLUSIONS OF LAW

1. This Court has jurisdiction over the parties to this action and over the subject matter of this action under the provisions of 28 U.S.C. § 1332. Venue is appropriate in this forum pursuant to 28 U.S.C. § 1391(a) and Rule 4(e) of the Local Rules for the Eastern District of Virginia.

2. The burden is on Home to prove that First Union's loss was occasioned by Ferrell's fraud or criminal act by clear and convincing evidence. Alternatively, Home has the burden to prove that First Union's loss was occasioned by any other dishonest act of Ferrell by a preponderance of the evidence. Continental Casualty Co. v. Burton, 795 F.2d 1187, 1191 (4th Cir. 1986); Winn v. Aleda Construction Co., 227 Va. 304, 308, 315 S.E.2d 193, 195 (1984). Dishonesty, fraud, and criminality, whether practiced through acts or omissions, can be proved by circumstantial evidence. Continental, 795 F.2d at 1191.

3. An essential element of either fraud or dishonesty is an intent to deceive. Arlington Trust Co. v. Hawkeye-Security Insurance Co., 301 F. Supp. 854, 858 (E.D. Va. 1969); see also Eglin Nat. Bank v. Home Indemnity Co., 583 F.2d 1281, 1285 (5th Cir. 1978). Mere negligence, incompetence, or error in judgment is not enough. Rock Island Bank v. Aetna Casualty and Surety Co., 706 F.2d 219, 222 (7th Cir. 1983).

4. The evidence regarding First Union's pleadings in the underlying lawsuit and the receivership proceeding, the ambiguous nature of the criminal investigations, and the payments by the Virginia State Bar's Client Security Fund, do not support the conclusion that the Policy exclusion applies. No legal proceeding to date has resulted in a finding, based on the standards of proof applicable here, that Ferrell engaged in crime, fraud, dishonesty, or intentional wrongdoing.

5. Furthermore, Ferrell's violation of certain Virginia



State Bar Disciplinary Rules does not establish dishonesty per se. The conduct itself must be judged by the standard for dishonesty previously set forth by the Court.

6. Home has failed to carry its burden of proof because it has failed to show: (a) that any payments made by Ferrell out of the trust account were not supported by appropriate deposits into the trust account; or (b) that Ferrell intentionally removed funds from the trust account to benefit himself or another not properly entitled to such funds. Home presents only circumstantial evidence regarding Ferrell's fraudulent or intentionally wrongful conduct. While this type of evidence is often sufficient, here it only creates certain suspicions and gives no indication, other than through conjecture, as to Ferrell's intent as to the First Union funds or as to the ultimate disposition of these funds. Circumstantial evidence must do more than raise suspicion; it must amount, in regards to the allegations of fraud and criminality, to clear and convincing proof. The evidence in this action has not risen to this high standard.

7. In determining whether the shortages to Ferrell's trust account were due to Ferrell's intentionally dishonest acts or only due to his negligence, the Court notes that there are two reasonable inferences which can be drawn from the facts as presented. If Home had conducted an audit of Ferrell's account records, which it was entitled to do, or subpoenaed certain material witnesses to testify -- notably one or more of the other signatories to the trust account -- then the scales may very well

have tipped conclusively in favor of one view or the other. However, the Court must play the cards that have been dealt to it. Thus, the Court finds that the circumstantial evidence presented by Home does no more than raise a suspicion that Ferrell acted with dishonest intent. Under Virginia law, speculation that Ferrell might have been dishonest is not enough. Continental, 795 F.2d at 1193. Home has failed to establish its defense by a preponderance of the evidence.

8. First Union is entitled to recovery from Home in the amount of \$136,713.00, plus pre-judgment interest from May 25, 1990 until the date of judgment, and post-judgment interest at the statutory rate from the date of the judgment until paid.

Let the Clerk send a copy of these Findings of Fact and Conclusions of Law and the accompanying Final Order to all counsel of record.

\_\_\_\_\_  
DATE

\_\_\_\_\_  
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF VIRGINIA

Richmond Division

FIRST UNION HOME EQUITY CORP., )  
 )  
Plaintiff, )  
 )  
v. ) File No. 91-407  
 )  
THE HOME INSURANCE COMPANY, )  
 )  
Defendant. )

FINAL ORDER

This matter came before the Court for a bench trial on January 20, 1992 on consideration of the Plaintiff's contract claim. For reasons set forth in the accompanying Findings of Fact and Conclusions of Law, made pursuant to Rule 52 of the Federal Rules of Civil Procedure, judgment is entered for the Plaintiff, and the Defendant is ordered to pay Plaintiff the amount of \$136,713.00, plus pre-judgment interest from May 25, 1990 until the date of judgment, and post-judgment interest at the statutory rate from the date of the judgment until paid.

It is so ORDERED.

Let the Clerk send a copy of this Order to all counsel of record.

\_\_\_\_\_  
DATE

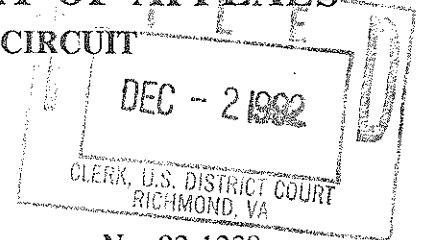
\_\_\_\_\_  
UNITED STATES DISTRICT JUDGE

THIS COPY FOR THE  
DISTRICT JUDGE

UNPUBLISHED

UNITED STATES COURT OF APPEALS  
FOR THE FOURTH CIRCUIT

FIRST UNION HOME EQUITY  
CORPORATION,  
*Plaintiff-Appellee,*  
v.  
THE HOME INSURANCE COMPANY,  
*Defendant-Appellant.*



Appeal from the United States District Court  
for the Eastern District of Virginia, at Richmond.  
Richard L. Williams, Senior District Judge.  
(CA-91-407)

Argued: October 26, 1992

Decided: December 2, 1992

Before HALL, WILKINSON, and LUTTIG, Circuit Judges.

---

Affirmed by unpublished per curiam opinion.

---

COUNSEL

**ARGUED:** Pamela Anne Bresnahan, SEMMES, BOWEN & SEMMES, Washington, D.C., for Appellant. Craig Thomas Merritt, CHRISTIAN, BARTON, EPPS, BRENT & CHAPPELL, Richmond, Virginia, for Appellee. **ON BRIEF:** Robert W. Hesselbacher, Jr., SEMMES, BOWEN & SEMMES, Washington, D.C., for Appellant. Michael W. Smith, James L. Banks, Jr., CHRISTIAN, BARTON, EPPS, BRENT & CHAPPELL, Richmond, Virginia, for Appellee.

Unpublished opinions are not binding precedent in this circuit. See I.O.P. 36.5 and 36.6.

---

### OPINION

#### PER CURIAM:

The question presented is whether appellant, The Home Insurance Company, has established a coverage exclusion from a policy of professional liability insurance. The policy excludes coverage for losses "based upon or arising out of any dishonest, deliberately fraudulent, criminal, maliciously or deliberately wrongful acts or omissions committed by the Insured." The district court conducted a bench trial and concluded that Home Insurance failed to carry its burden of proof that the insured had committed fraudulent or intentionally wrongful acts. Home Insurance presented no more than circumstantial evidence that the insured had intentionally misappropriated funds. We have reviewed the issues, studied the briefs and the record, and heard oral argument. We do not think that the district court's factual findings were clearly erroneous or that it applied an erroneous legal standard. We therefore affirm on the basis of the district court's opinion.

*AFFIRMED*