

Exclusion for Claims Arising Out of Defective Title Does Not Apply to Causes of Action That Could Exist Independently of Defective Title

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The United States Court of Appeals for the Eleventh Circuit, applying Georgia law, has held that an exclusion for claims "arising out of any defective deed or title" did not apply to breach of contract and negligent misrepresentation causes of action asserted against a mortgage lender because those causes of action could have been maintained absent defective title. *USMoney Source, Inc. v. Am. Int'l Specialty Lines Ins. Co.*, 2008 WL 2684346 (11th Cir. July 10, 2008).

The insured, a mortgage lender, sought indemnification under an E&O policy for a judgment against it on breach of contract, negligent misrepresentation, and common law negligence causes of action. In the underlying litigation, a bank had sued the mortgage lender to recover unpaid loans that it had advanced to the lender to originate residential mortgages. The mortgage lender failed to repay the loans within 30 days as required by the line of credit agreement, and "the loans were not secured by a valid and enforceable first lien on each of the subject properties." The bank further alleged that the mortgage lender negligently submitted funding requests and negligently misrepresented facts in its funding requests.

The mortgage lender argued that the exclusion for claims "arising out of defective title" did not apply because, even if the titles were vested in the borrowers and the bank had valid first priority liens on the properties, the bank would still have had viable causes of action against the mortgage lender. The court surveyed Georgia decisions interpreting the phrase "arising out of" as used in policy exclusions and concluded that, under Georgia law, "a claim does not 'arise out of' a circumstance if, independent of that circumstance, the claim could still exist."

The court determined that "the excluded circumstance—defective title—was not necessary" to two of the bank's causes of action against the mortgage lender. The court observed that the court in the underlying action had found that the mortgage lender breached the line of credit agreement by submitting funding requests with false information. In addition, the court in the underlying suit found that the mortgage lender made negligent representations regarding liens securing the loans. The court concluded that these findings supported the mortgage lender's argument that the bank had valid causes of action that were unrelated to any defect in

title and existed independently of the circumstance of defective title. Therefore, the court held that those two causes of action—breach of contract and negligent misrepresentation—did not "arise out of" defective title, and the exclusion did not apply.