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ALERT

District Court: Coverage for Underlying Misappropriation Unavailable Under E&O Policy

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The United States District Court for the Northern District of Ohio, applying Ohio law, has granted an insurer's motion for summary judgment, holding that an errors and omissions policy did not provide coverage for an insured title insurance company's indemnity obligations pursuant to closure protection letters (CPLs). *Entitle Ins. Co. v. Darwin Select Ins. Co.*, 2013 WL 422712 (N.D. Ohio). In so holding, the court found that the issuance of CPLs by the insured constituted "Professional Services" but ruled that the insured was not legally responsible for the amounts at issue, and that in any event, the amounts paid pursuant to the CPLs were not "Loss."

The insured title insurance company hired another company to sell and issue title insurance on the insured's behalf as a "non-exclusive policy issuing agent." In connection with this arrangement, the insured offered CPLs to the individuals who purchased the title insurance, which required the insured to reimburse its clients for losses resulting from the hired company's fraud, dishonesty or negligence in closing the title insurance. Pursuant to the CPLs, after it was discovered that the hired company misappropriated client escrow funds, the insured determined that it was contractually obligated to reimburse its clients to which it issued CPLs, ultimately paying in excess of $3.5 million. The insured sought coverage for those amounts under its E&O policy.

The E&O policy provided coverage for "Loss . . . from any Claim . . . first made against [the insured] during the Policy Period . . . for Professional Liability Wrongful Acts . . . ." The policy defined "Professional Liability Wrongful Acts" to mean "any actual or alleged

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act, error, omission, misstatement or misleading statement in the performance of or failure to perform Professional Services . . . by any Insured, or by an individual or entity for whom the Company is legally responsible." The policy, in turn, defined "Professional Services" as "services performed by the Company or any Insured Person on behalf of the Company, for a policyholder, customer or client of the Company, pursuant to a policy of insurance issued by, or a written contract with, the Company, in the usual and customary conduct of the Company's business, for a fee or other business consideration."

As an initial matter, the court held that because the insured "issued CPLs to clients it obtains by virtue of its relationship with [the hired company]" and "[e]ach CPL is a binding contract between [the insured] and the client, and [the insured] claims CPLs are customary in the industry to increase sales," the insured's issuance of CPLs are "Professional Services."

The court then addressed whether there was an act, error, omission, misstatement or misleading statement either by the insured, or by another entity for whom the insured was "legally responsible" to constitute a "Professional Liability Wrongful Act." The court found, however, that "[t]he misconduct that occurred was [the hired company's] misappropriation of escrow funds, not [the insured's] issuance of CPLs." The court further stated that the "issuance of CPLs did not make [the insured] legally responsible for [the hired company]. Instead, the CPLs made [the insured] *contractually* responsible" and "a contractual obligation to pay is not the same as a legal obligation to pay." (emphasis in original.) The court also noted that the insured "only reimbursed the losses stemming from [the hired company's] misconduct for clients who received a CPL" and that "[i]n the absence of the CPLs, it would not have paid for any of the losses occasioned by [the hired company's] fraud." For these reasons, the court held that the insured "was not legally responsible for [the hired company], and [the insured] did not engage in any misconduct in its issuance of CPLs, therefore there is no Professional Liability Wrongful Act."

The court also held that, even if the claim fell within the insuring agreement, the amounts at issue do not constitute covered "Loss." In this regard, the court noted that the policy's definition of "Loss" explicitly carves out "amounts due pursuant to an express contract or agreement . . . ." Further, the policy contained an exclusion "for actual or alleged liability under any express contract or agreement," which the court held applied to preclude coverage here where the "CPLs are a debt [the insured] voluntarily accepted, not a loss resulting from a wrongful act within the meaning of the Policy." The court also recognized that to hold otherwise would allow a company to "enter into a contract safe in the assumption that if he later decides to engage in an act which might be considered a breach, the insurance company will step forward to cover the consequences of his act if he was wrong; and if he was right, he still walks away with no consequence to himself. Such a practice is inimical to the entire concept of insurance."

The opinion is available here.