

# Sixth Circuit Holds E&O Policy Exclusions for Specific Conduct Apply Even if Conduct Was Negligent

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The U.S. Court of Appeals for the Sixth Circuit, applying Michigan law, has held that exclusions in an E&O policy that barred coverage for, among other things, claims arising out of breach of contract, commingling funds and embezzlement, applied notwithstanding the policyholder's argument that the conduct at issue resulted from negligence and was not intentional. *Northland Ins. Co. v. Stewart Title & Guar. Co.*, No. 01-1729, 2003 WL 1950030 (6th Cir. Apr. 25, 2003).

The insurer issued a policy to a title and escrow agent company and its directors. The policy required the insurer to "pay those sums that the insured becomes legally obligated to pay as damages because of a negligent act, error or omission in the rendering of or failure to render professional services as a title agent, abstractor, escrow agent and notary public." The policy excluded coverage for, among other things: (1) "Contractual Liability - Any damages for liability of other which the insured has assumed under any oral or written contract or agreement;" (2) "Criminal Acts - Any damages arising out of dishonest, fraudulent, criminal or malicious act or omission by or on behalf of or at the direction of any insured;" and (3) "Handling of Funds - Any damages arising out of the commingling, conversion, misappropriation of defalcation of funds or other property."

A third party sued the title and escrow agent and three of its directors for breach of an underwriting agreement, breach of fiduciary duty, breach of the state insurance code, embezzlement, and the conversion and commingling of funds based on the allegation that the policyholder's escrow account was missing approximately \$300,000. The insurer filed a declaratory judgment action seeking a determination that it had no duty to defend or indemnify.

The Sixth Circuit rejected the company's argument that it was entitled to coverage because any liability resulted from negligent conduct, concluding that the insurer had no obligation under the policy because the "damages alleged in the [underlying complaint] resulted from conduct that was excluded by the contract." The court initially noted, with respect to the exclusions, that "[t]he policy contains no language limiting these exclusions to intentional acts; rather, the exclusions are for damage resulting from specific kinds of conduct without regard to whether that conduct was intentional or negligent." Thus, the court determined that the

breach of contract was "expressly excluded by the contractual liability exclusion." With respect to the embezzlement count, the court noted that embezzlement was not specifically excluded, but reasoned that embezzlement requires intentional conduct, and the policy provided coverage only for negligent acts. The court reasoned that the "Handling of Funds" exclusion clearly applied to the conversion and commingling of funds allegations and therefore barred coverage for those allegations. The court explained that "even if the insureds acted without knowledge of the dishonest, fraudulent, criminal or malicious nature of the act or omission, the damages, regardless of *mens rea*, would still be excluded from coverage if these damages resulted from one of the other listed exclusions."

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