

Eighth Circuit Holds Prior Knowledge Exclusion Bars Coverage for Title Insurer Indemnification Claim

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The United States Court of Appeals for the Eighth Circuit, applying Missouri law, has held that no coverage is available where a land title agent had knowledge at the time of the inception of an E&O policy that a future indemnification demand by a title insurer was likely. *Lexington Ins. Co. v. Integrity Land Title Co., Inc.*, 2013 WL 3924320 (8th Cir. July 31, 2013). The court further held that the policy's exclusion for claims arising out of the release of funds without obtaining proper lien waivers independently barred coverage.

The insured land title agent had issued title commitments and title insurance policies for a number of properties in residential developments. In so doing, the title agent had failed to investigate whether subcontractors had been paid or to include exclusions in the title insurance policies for later-filed mechanics liens. The title agent had also disbursed funds for certain aspects of the development, but failed to obtain lien waivers prior to disbursement. The title insurer that underwrote the policies defended, and made payments on behalf of, the title-insurance policyholders, and then demanded indemnification from the title agent. The title insurer filed suit against the title agent in Missouri state court, also naming as a defendant the title agent's E&O insurer.

The title agent's E&O insurer filed a declaratory judgment action seeking a determination of its defense and coverage obligations regarding the title insurer's indemnification claim and several other claims against the title agent, and the title insurer intervened in the coverage action. The trial court denied the title insurer's motion for a stay to allow the coverage issues to be decided in its state court suit and granted summary judgment to the E&O insurer. The appellate court affirmed.

The court held that the E&O policy's prior knowledge exclusion applied to bar coverage for the title insurer's indemnification claim. The court noted that the terms of the exclusion, which precluded coverage for claims "based upon or arising out of any alleged act, error omission or circumstance likely to give rise to a Claim that an Insured had knowledge of prior to the effective date of this policy," were similar to a question on the policy's application. The court found that, prior to the policy's effective date and the application date, the title agent had received calls from homeowners who had been served with liens, had forwarded numerous lien claims to the title insurer, had been sued by one of the unpaid subcontractors, and had been quoted in a

newspaper article saying that the property owners should contact their title insurers. Based on this information, the court found that the title agent had actual knowledge of facts that could possibly give rise to lien claims against property owners, claims against the title insurer, and ultimately indemnification claims against the title agent by the title insurer. The court rejected the argument that neither the title insurer's nor the title agent's liability had been firmly established by the policy inception date, finding that this interpretation unreasonably attempted to read the term "likely" out of the exclusion.

The court also held that the policy's lien-waiver exclusion, which barred coverage for "any claim arising out of any release of funds without receipt of . . . appropriate waivers or releases of liens from any contractor, subcontractor, or materials or service provider," barred coverage. The court found that the title insurer had specifically alleged that the title agent was negligent in failing to obtain lien waivers, failing to place funds into escrow, failing to apply funds to unpaid contractors, and failing to postpone closing pending payment to contractors. The court rejected the argument that the E&O insurer had waived this defense by not raising the exclusion when it initially denied coverage. The court held that, under Missouri law, an insurer may later raise additional coverage exclusions if they are not inconsistent with the original basis for denying coverage.

Finally, the court also held that the trial court had not abused its discretion in declining to stay the federal declaratory judgment action. The court found that the pending state court actions, including the title insurer's indemnification suit, were unlikely to address the coverage issues between the title agent and its E&O insurer.