

ALERT

Allegation of Negligence Sufficient to Overcome Handling of Funds Exclusion to Trigger Duty to Defend

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Applying Virginia law, the United States Court of Appeals for the Fourth Circuit has held that an insurer had a duty to defend a closing agent under a real estate professional liability policy, rejecting the insurer's argument that a "handling of funds exclusion" barred coverage where the underlying complaint alleged that the insured negligently transferred its client's funds. *First Tenn. Bank Nat'l Ass'n v. St. Paul Fire & Marine Ins. Co.*, No. 11-1781, 2012 WL 6634911 (4th Cir. Dec. 21, 2012).

A mortgage creditor contended that the closing agent was obligated to hold the creditor's funds in trust and distribute them to a mortgage originator as directed upon closing. After learning of cancelled deals, the agent allegedly distributed the creditor's funds to the originator. The creditor sued the closing agent for negligent handling of its funds. The insurer denied coverage based on the "handling of funds" (HOF) exclusion in the policy, which barred coverage for claims resulting from "[a]ny unauthorized act committed by any protected person ... depriv[ing] an owner of the use of its funds."

In the coverage litigation that followed, the court construed the term "unauthorized" to mean "outside the scope of the insured's authority." The court further found that a negligent violation of a principal's instructions may nonetheless be within the scope of the agent's authority such that the act complained of is not unauthorized. Accordingly, the court concluded that the creditor's complaint allowed for the possibility of coverage, and therefore triggered the insurer's duty to defend. The court did, however, express that its decision had no bearing on the insurer's duty to indemnify, explaining that the duty

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to indemnify arises only if the insured's damages are established as being actually covered by the terms of the policy.

The opinion is available [here](#).