

**RECOUPING LOSSES DUE TO
SETTLEMENT AGENT WRONGDOING**

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I. INTRODUCTION

As the current recession continues, litigation is on the rise.¹ , including litigation on claims against title insurers and settlement agents.² The relationship between title insurers and settlement agents³ is replete with risk of loss to the title insurer. Some losses under title insurance policies are unavoidable. However, losses from errors, omissions or intentional acts of the title insurer's agents may be mitigated.

One common way a title insurer can mitigate losses is to require settlement agents to purchase errors and omissions (E & O) insurance. This is professional negligence or malpractice insurance for the real estate closing professional. Some states—i.e. Virginia, Ohio, and Oregon—require settlement agents to carry a minimum amount of coverage.

In a perfect world, a title insurance company could recoup its losses on claims paid to its insureds from the E & O provider. In practice, settlement agents and their E & O providers negotiate a settlement for the agent's negligence.

Nevertheless, to successfully recover funds for the settlement agent's negligence or misdeeds, the title insurer must establish three conditions: 1) the settlement agent's duty to indemnify, 2) a breach of that duty, and 3) the availability of sufficient funds to satisfy the claim. Assuming there is a breach of duty, this article discusses how to establish the settlement agent's

¹ See generally Martha Neil, *Dismal Economy? Not for Companies Funding Corporate Litigation*, ABA L.J., Jun 2, 2009 http://www.abajournal.com/news/dismal_economy_not_for_companies_funding_corporate_litigation; Jason L. Miller, *Financial Crisis to Fuel Rise in Litigation*, WebProNews, Oct. 14, 2008, <http://www.webpronews.com/topnews/2008/10/14/financial-crisis-to-fuel-rise-in-litigation>; Steve Vockrodt, *Tough Economy Will Build Up Rise in Construction Litigation*, KANSAS CITY B.J., Nov. 14, 2008, <http://www.bizjournals.com/kansascity/stories/2008/11/17/story10.html>.

² See Mary P. Gallagher, *Home Buyers' Suit Seeks to Bar Overcharges by Title Insurers*, N.J. L.J., May 5, 2009, <http://www.law.com/jsp/article.jsp?id=1202430437832>; *Real Estate Settlement Agent Gets Six Years for Scheme*, PHIL. BUS. J., June 3, 2008, <http://www.bizjournals.com/philadelphia/stories/2008/06/02/daily16.html>; see generally Mortgage Fraud Blog Home Page, <http://www.mortgagefraudblog.com> (last visited July 23, 2009). Champions Blog, <http://blog.championsschool.com/index.php?itemid=27> (May 17, 2008).

³ Throughout this article the term settlement agent includes persons that provide closing services in real estate transactions, and could be called an escrow or closing agent depending on the state where the transaction occurs.

duty to indemnify a title insurer, how to use the settlement agent's E & O policy as a source of funds, and finally, the defenses an E & O provider may assert in an attempt to bar recovery.

II. **ESTABLISHING A DUTY TO INDEMNIFY**

Integral to recouping monies paid to an insured under a title policy is establishing a duty for the agent to indemnify the title company for the agent's professional negligence or wrongful acts. This can be done in several ways. Title insurers can contractually require the settlement agent to indemnify the title company for damages that result from the agent's mistakes through agency agreements. This is a sort of personal indemnity agreement issued by the settlement agent to the title company. Another way to establish a duty to indemnify is through the operation of common law. Each will be discussed.

A. Contractual Obligation

The most common way to establish a settlement agent's duty to indemnify the title company for losses caused by errors or omissions is through a contractual obligation, or indemnification agreement. In this context, a loss usually means a title insurer's payment of a claim under a title insurance policy. Under an indemnity agreement there are two theories of recovery: 1) one based on actual liability, and 2) one based on potential liability.

A title insurer can recover under an actual liability standard where it has paid a claim without notifying the indemnitor settlement agent. Generally, to recover under actual liability, the indemnitee has to demonstrate: 1) that the indemnitee was under legal compulsion to satisfy a claim, 2) the settlement of the claim was reasonable, and 3) unlawful action of the indemnitor proximately caused the injury to the original plaintiff.⁴

⁴ See *Winchester Homes v. Hoover Universal*, 39 Va. Cir. 107, 115 (Fairfax 1996) (citing *Vaughn v. Farrell Lines, Inc.*, 937 F.2d 953 (4th Cir. 1991)); see also *Chicago Title Ins. Co. v. IMG Exeter Assoc.*, 1993 U.S. App. LEXIS 2052, *9-10 (4th Cir. Feb. 8, 1993); *Rowan Cos. v. Acadian Ambulance Serv.*, 2008 U.S. Dist. LEXIS 36573, *20 (S.D. Tex. May 2, 2008); *Manley v. AmBase Corp.*, 121 F. Supp. 2d 758, 764-65 (S.D.N.Y. 2003).

Alternatively, if a title insurer notifies the settlement agent of a pending claim, the title insurer can recover for potential liability. To recover under the potential liability standard, the indemnitee must demonstrate that the indemnitor had: 1) actual notice of the claim, 2) opportunity to defend the claim, 3) right to participate in any settlement negotiations, and 4) the settlement was reasonable in light of potential liability.⁵

B. Common Law Obligation

Without an indemnity agreement, the common law will still provide the title insurer with a right of recovery against the settlement agent. Two theories provide for such a right of recovery. The first theory is subrogation of right, and the second is equitable indemnification.

A title insurer can recover from a settlement agent under a subrogation theory, meaning, “the substitution of [an insurer] in place of the [insured] to whose rights [the insurer] succeeds in relation to the [claim].”⁶ Subrogation of right arises as a matter of law—it is purely equitable in nature and does not rely on contract or privity of the parties.⁷ This is generally referred to as “stepping into the shoes of the insured.”⁸ To assert subrogation of right to recovery from the agent, the title company must establish two things: 1) A direct cause of action between the

⁵ See *Winchester Homes*, 39 Va. Cir. at 115 (citing *Atlantic Richfield Co. v. Interstate Oil Transport Co.*, 784 F.2d 106 (2d Cir. 1986)); see also *Illinois C. G. R. Co. v. Crown Zellerbach Corp.*, 859 F.2d 386, 389 (5th Cir. 1988); *Fashion House, Inc. v. K Mart Corp.*, 892 F.2d 1076, 1094 (1st Cir. 1989); *Cox v. Brinderson Corp.*, 1992 U.S. App. LEXIS 30974, *5 (9th Cir. Oct 7, 1992); *James v. Hyatt Corp. of Delaware*, 981 F.2d 810 (5th Cir. 1993); *Manley*, 121 F. Supp. 2d at 764-65.

⁶ *Centreville Car Care Center, Inc. v. North American Mortgage*, 263 Va. 339, 345 (2002); see also *First American Title Ins. v. Brown*, 7 Va. Cir. 549 (1979) (citing *McKay v. Citizens Rapid Transit Co.*, 190 Va. 851 (1950)); cf. *Md. Casualty Co. v. Nat'l Am. Ins. Co.*, 56 Cal. Rptr. 2d 498, 501-02 (Cal. Ct. App. 1996) (noting insurer's right to take over the claims of the insured).

⁷ *XL Specialty Ins. Co. v. DOT*, 269 Va. 362, 369 (2005) (citing *Centreville Car Care Center, Inc. v. North American Mortgage*, 263 Va. 339, 345 (2002)); see generally 73 AM. JUR. 2D *Subrogation* § 1 (2001 & Supp. 2009).

⁸ 73 AM. JUR. 2D *Subrogation* § 1 (2001 & Supp. 2009).

insured and the settlement agent,⁹ and 2) that the title company has already settled the claim with the insured.¹⁰ The title insurer is only entitled to recover to the extent of actual liability, or the amount actually paid to the insured under the title insurance policy.

A less used method of recovery is suing under a theory of equitable indemnification. Unlike subrogation, under equitable indemnification the title insurer would seek recovery for an actual judgment against the title insurer; thus the title insurer would seek recovery under its own right.¹¹ “Equitable indemnification arises when a party without personal fault, is nevertheless legally liable for damages caused by the negligence of another.”¹² This may arise where the title insurer is sued directly for a settlement agent’s wrongful acts (i.e. embezzlement, misappropriation of funds).¹³ Essential to a claim for equitable indemnification is an underlying decision of fault against the party from whom the insurer seeks recovery.¹⁴

Under these common law methods, regardless of the theory used to recover from the settlement agent, recovery is limited to the lesser of either the extent of actual damages caused by the settlement agent, or the amount paid by the title company to the insured. An insurer is entitled to no greater rights than those of the insured.¹⁵

⁹ See *Ohio Casualty Insurance Co. v. State Farm Fire & Casualty Co.*, 262 Va.238, 241 (2001).

¹⁰ *Title Insurance Co. v. Industrial Bank*, 156 Va. 322 (1931).

¹¹ 41 AM. JUR. 2D *Indemnity* §4 (2005)

¹² *Carr v. The Homes Insurance Co.*, 250 Va. 427 (1995).

¹³ A title insurer may be exposed to direct liability for a settlement agent’s acts where the agent is either an employee of the title insurer, or is an agent *of* the title insurer.

¹⁴ *Id.*

¹⁵ *Peerless Ins. Co. v. Fairfax*, 274 Va. 236 (2007); *Ohio Casualty Insurance Co.*, 262 Va. at 241.

III. ENSURING SUFFICIENT FUNDS ARE AVAILABLE TO SATISFY A CLAIM

Ensuring access to adequate capital is another important element in an indemnification relationship. Although a title insurer can use several strategies to establish a settlement agent's duty to indemnify, such a duty is useless if the agent does not have adequate resources to satisfy a claim. There are generally two approaches to ensuring adequate capital: 1) the state requires a settlement agent to demonstrate financial responsibility with statutory E & O insurance coverage requirements, or 2) the title insurer, as a condition of the contractor agreement, requires that the agent carry professional negligence insurance.

A. **Federal and State Requirements**

Settlement agents are subject to regulation by both federal and state statutes. Under the federal Real Estate Settlement Procedures Act (RESPA),¹⁶ settlement agents are required to fill out a uniform settlement statement—disclosing all fees related to the closing of the loan transaction—as drafted by the Secretary of Housing and Urban Development. RESPA's purpose is to increase the disclosure of fees and to eliminate kickback schemes that tend to increase the cost of settlement services. However, RESPA does not require settlement agents to maintain any set level of fiscal responsibility or ability to satisfy claims against the agent for professional negligence.

Some states have filled in the gaps of RESPA with their own requirements.¹⁷ In Virginia, settlement agents are required by statute to carry a threshold level of insurance for certification by the state. The Consumer Real Estate Settlement Protection Act (CRESPA)¹⁸ sets out the

¹⁶ 12 U.S.C. § 1201 *et seq.*

¹⁷ *Infra* note 22.

¹⁸ VA. CODE ANN. §§ 6.1-2.19 to -2.29 (LEXIS through 2009 legislation).

practice requirements and duties of settlement agents. The Act's fundamental purpose is to ensure financial responsibility and consumer protection in settlement procedures and practices.¹⁹

Unlike RESPA, CRESPA covers both practices during settlement and base financial requirements—it requires:

D. A settlement agent other than a financial institution described in subsection A or title insurance company as defined in § 38.2-4601, shall maintain the following to the satisfaction of the appropriate licensing authority:

1. An errors and omissions or malpractice insurance policy providing a minimum of \$ 250,000 in coverage;

2. A blanket fidelity bond or employee dishonesty insurance policy covering persons employed by the settlement agent providing a minimum of \$100,000 in coverage. When the settlement agent has no employees except the owners, partners, shareholders or members, the settlement agent may apply to the appropriate licensing authority for a waiver of this fidelity bond or employee dishonesty requirement; and

3. A surety bond of not less than \$200,000.²⁰

However, CRESPA does not govern the terms of an errors and omissions policy that might be used to satisfy the requirements of section 6.1-2.21. Also, CRESPA has limited application—it only applies to transactions involving residential properties containing four or fewer residential units.²¹

¹⁹ See generally Susan M. Pesner and Martin Conway, *Property Law*, 31 U. RICH. L. REV. 1145, 1146-51 (1997).

²⁰ VA. CODE ANN. § 6.1-2.21. Virginia courts are presently split as to whether a title insurer can recover from a CRESPA bond. Compare *First American Title Insur. Co. v. Western Surety Co.*, Case No. 1:09-CV-00403 (E.D. Va. May 27, 2009) (allowing common law breach of contract claim to recover from CRESPA bond) with *Chicago Title Insur. Co. v. Main Street Title & Escrow LLC*, Case No. CL-2008-7406 (Fairfax 2008) (dismissing claim against the CRESPA bond) .

²¹ § 6.1-2.19(C).

Other states have statutes that operate similarly to CRESPA.²² In Ohio, every title insurance agent and any subcontractor is required to maintain an errors and omissions policy in an amount exceeding minimum limits as set by a superintendent.²³ In Oregon, every escrow agent is required to deposit a surety bond before being licensed as an agent.²⁴ The amount of the bond is set by statute and correlates to the amount of client funds the agent believes he/she may be handling.²⁵ Similarly, Washington, as a condition precedent to becoming an escrow agent, requires the agent to have a fidelity bond of \$200,000, an errors and omissions policy with coverage of \$50,000, and a surety bond of \$10,000.²⁶

²² OHIO REV. CODE ANN. § 3953.23 (LEXIS through 2009 legislation); OR. REV. STAT. § 696.525 (2007); WASH. REV. CODE § 18.44.201 (LEXIS through 2009 legislation); *see also* ARK. CODE § 18-12-703 (LEXIS through 2008) (procedures regarding closing and settlement of funds); CAL. FIN. CODE DIV. 6 (regulations regarding escrow agents); COLO. REV. STAT. § 38-35-125 (LEXIS through 2008 legislation) (procedures regarding closing and settlement services); D.C. CODE §§ 42-2401 to -2407 (LEXIS through 2009 legislation) (governing disbursement of settlement proceeds); FLA. ST. ANN. § 475.709 (duties of closing agent); GA. CODE ANN. §§ 44-14-1 to -13 (LEXIS through 2009 legislation); KAN. STAT. ANN. § 58-2309a. (entry of satisfaction by lender or closing agent); LA. REV. STAT. ANN. § 22:514, 518, 530, 532 (authorized activities, errors and omissions requirements, maintenance requirements of closing services); ME. REV. STAT. ANN. § 3-316 (Real estate settlement procedures—incorporating RESPA); MINN. STAT. § 507.45 (LEXIS through 2008 legislation); MO. REV. STAT. § 339.205 (Civil penalty may be imposed . . . settlement procedures); MONT. CODE ANN. § 33-25-201 (escrow, closing or settlement services); NEB. REV. STAT. § 44-19.116 (Conditions for providing escrow, settlement, closing services); N.C. Gen Stat. § 45-A1 (Consumer Real Estate Settlement Protection Act); TENN. CODE ANN. §§ 47-32-101 to -107 (Residential Closing Funds Distribution Act of 2005); TEX. INSUR. CODE ANN. §§ 2702.001-2702.103 (chapter on closing and settlement); VT. STAT. ANN. § 204; *cf.* ALASKA STAT. § 08.88.172 (effective Mar. 1, 2010) (requires all real estate brokers and licensees to carry errors and omission insurance); MD. CODE ANN. § 14-127 (governing real estate settlements); MISS. CODE ANN. § 81-12-165; TENN. CODE ANN. § 62-13-505 (immunity of title insurers, abstractors, and closing agents re commercial real estate); WIS. STAT. § 708.10; WYO. STAT. ANN. §§ 26-23-314 to -324 (governing conditions for providing settlement services, and authorized practices of title agents).

²³ OHIO REV. CODE ANN. § 3953.23. Chapter 119 covers regulations regarding the superintendent. The limits set by the superintendent cover minimum amounts, terms, and conditions of the coverage.

²⁴ OR. REV. STAT. § 696.525.

²⁵ The smallest bond is \$50,000 for an agent that handles less than \$30 million of client funds; the biggest bond required is \$500,000 for an agent handling \$300 million or more of client funds.

²⁶ WASH. REV. CODE § 18.44.201.

B. Contractual Requirements

Another way to ensure adequate capital to satisfy potential claims is for the title company to require the closing agent to carry an errors and omissions policy. There are several benefits to this approach. Namely, the title company can mandate the terms and conditions of the policy acquired by the agent. The title company can mandate the type of policy acquired, including its coverage period; the types of claims covered; the types of actions excluded under the policy, and the limits of financial coverage.

i. Type of Policy

There are three general categories of policy: 1) claims-made, 2) occurrence, and 3) hybrid.²⁷ Under a claims-made policy, the errors and omissions insurer has agreed to cover any claims that are filed and reported to the insurer during the period of coverage.²⁸ Regardless of when the act creating liability occurred, if the claim is asserted against the insured during the policy period, then it will be within the coverage of the policy. Sometimes insurers limit the retrospective reach of these policies by setting an origination date. Errors or omissions that occur before the origination date are not within the purview of the policy.

An occurrence policy is a traditional insurance policy. It operates exactly like auto insurance—if an act giving rise to liability occurs when the policy is in place, then it will be within the coverage of the policy.²⁹

The third type of policy—hybrid—mixes elements of both occurrence and claims-made policies. Under this policy, the insurer limits coverable claims to those that occur, are asserted

²⁷ See 43 AM JUR 2D *Insurance* §§ 687, 689 (West 2003 & Supp. 2009).

²⁸ *Id.* § 689.

²⁹ *Id.* § 687.

against the insured, and are reported to the insurer. This is fundamentally an occurrence policy that covers only those claims that are made during the policy period.

Out of the three, hybrid policies have generated the most controversy. Some states do not recognize hybrid policies as valid. The highest court in New Jersey has held that where a claims-made policy does not apply retroactively, it is against public policy.³⁰ The court opined that such an insurance policy would essentially leave the insured uncovered for most of the first year of coverage. Courts in Minnesota have followed New Jersey's lead. Where a claims-made policy excludes reasonably foreseeable claims at the time of application, and it effectively provides no retroactive coverage, such a policy is void as contrary to public policy.³¹

A similar controversy over a hybrid policy occurred in New York. In *Heen & Flint Associates v. Travelers Indemnity Co.*, the insurer included a provision regarding renewal of the policy that gave the insurer the right to deny renewal based on notice of a claim that arose during previous coverage, but was not yet asserted against the insured.³² This condition to renewal was deemed void as unconscionable because it created a situation where the insurer could receive advance notice of a potentially covered claim and ensure that coverage would be denied.³³

However, as an exception to the New Jersey rule, where there is a good reason to limit the policy to a set time span, such limitation will not be considered void as against public policy.³⁴ This was the case in *Guaranty Insurance Co. v. Saltman*. In *Guaranty Insurance Co.*,

³⁰ Sparks v. St. Paul Insurance Co., 492 A.2d 406 (N.J. 1985).

³¹ St. Paul Mercury Insurance Co. v. JBA International, Inc., 2003 U.S. Dist. LEXIS 17711, *20 (D. Minn. Sept. 30, 2003).

³² 400 N.Y.S.2d 994, 999 (N.Y. Sup.Ct. 1977).

³³ *Id.*

³⁴ 529 A.2d 995 (N.J. Super. App. Div. 1987)

the insurer and insured agreed on a claims-made policy with a retroactive limit set for a few weeks before the policy was delivered.³⁵ The insured already had a policy covering acts arising from activities that pre-dated the limited claims-made policy. Because all activities were covered by some type of policy, and the insured intended to select the terms of the policy in question, the court ratified the limitation.³⁶

Most courts have not followed the New Jersey rule. They have asserted that where the terms were clear and unambiguous, retroactive coverage was merely a matter of contract and as such the bargained for terms were enforceable.³⁷ Virginia's courts have not yet decided this matter.

ii. Terms of Coverage

As with any contractual relationship, the duty of an errors and omissions insurer varies according to the exact wording of the contract. There are generally two types of coverage clauses: those that cover wrongful acts, and those that cover negligent acts.

In a policy that covers claims against the settlement agent for wrongful acts, the insurer will indemnify the insured for:

[T]he Loss of the Insured arising from a Claim . . . *for any actual or alleged Wrongful Act of any Insured* in the rendering or failure to render Professional Services.³⁸

³⁵ *Id.* at 997.

³⁶ *Id.*

³⁷ *See, e.g.,* Oceanics, Inc. v. Petroleum Distributing Co., 292 So.2d 190, 192 (La. 1974); Gereboff v. Home Indemnity Co., 383 A.2d 1024 1028 (R.I. 1978); Stine v. Continental Cas. Co., 349 N.W.2d 127, 137-38 (Mich 1984); Merrill & Steeley v. Admiral Ins. Co., 275 Cal.Rptr. 280, 284 (Cal.App. 1990).

³⁸ PMI Mortgage Insurance Co. v. American International Specialty Lines Insurance Co., 394 F.3d 761 (9th Cir. 2005) (emphasis in original).

A slight, but important, variant can be found in a different coverage clause:

[Insurer will] 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, abstracter, escrow agent and notary public[.]³⁹

The use of “wrongful act” as opposed to “negligent act” has important consequences. *PMI Mortgage Insurance* demonstrates this difference. In *PMI Mortgage Insurance*, the insured and its agents were involved in a kick back scheme that violated procedural ban under RESPA. The insurer claimed that such acts were not covered because they were intentional wrongs. The court concluded, however, that because the policy covered all “wrongful acts” as opposed to just “negligent acts,” and an intentional violation of RESPA was a wrongful act, the insured was entitled to coverage.⁴⁰

Whether a policy covers wrongful acts or negligent acts, all insurance policies require any liability to arise out of the provision of professional services to be covered. Often, the meaning of “professional services” is defined within the insurance policy as “those services of the Company permitted by law or regulation rendered by an Insured . . . pursuant to an agreement with the customer or client.”⁴¹ However, sometimes professional services are not defined within the policy. When not defined, courts have generally defined “professional services” as:

Something more than an act flowing from mere employment or vocation . . . [a] 'professional' act or service is one arising out of a vocation, calling, occupation, or employment involving specialized knowledge, labor, or skill, and the labor or skill involved is predominantly mental or intellectual, rather than physical or manual.⁴²

³⁹ *Northland Ins. Co. v. Stewart Title Co.*, 327 F.3d 448 (6th Cir. 2003) (emphasis added).

⁴⁰ *PMI Mortgage Insurance Co.*, 394 F.3d at 768.

⁴¹ *Id.* at 762.

⁴² *Bank of California, N.A. v. Opie*, 663 F.2d 977, 981 (9th Cir. 1981).

In determining whether a particular act is of a professional nature, the courts generally look to the nature of the act itself, and not the title of the person performing the act.⁴³

Mundane administrative tasks are not generally considered part of a professional service—such tasks include the preparation of bills.⁴⁴

iii. Exclusions from Coverage

Most insurance contracts will contain specific acts that are excluded from coverage. As a general rule, all clauses excluding coverage will be interpreted liberally with an aim toward providing for the greatest amount of coverage.⁴⁵ Any ambiguity will be construed against the insurer.⁴⁶ Typically an insurer will exclude errors from billing, criminal conduct, intentional conduct, or any mishandling of client funds from an errors and omissions policy.

IV. COMMON BARRIERS TO RECOVERY

Despite the availability of insurance proceeds to satisfy a claim against the settlement agent for his/her negligence or intentional misconduct, E & O insurance providers have created

⁴³ See, e.g., *Bank of California*, 663 F.2d at 981; *Pacific Title Insurance Co. v. Burnette Title, Inc.*, 380 F.3d 1061 (8th Cir. 2004); *Bohreer v. Erie Ins. Group*, 475 F.Supp. 2d 578, 585 (E.D. Va. 2007) (citing *St. Paul Fire & Marine Ins. Co. v. Jacobsen*, 826 F.Supp. 155, 169-61 (E.D. Va. 1993)); *Firemans' Fund Insurance Co. v. Puget Sound Escrow Closures, Inc.*, 979 P.2d 872 (Wash. 1999).

⁴⁴ *Davis & Meyer Law v. ProNational Insurance Co.*, 2007 Ohio 3552 (Ct. App. Oh. 2007); *Gregg & Valby. LLP v. Great American Insurance Co.*, 316 F.Supp. 2d 505 (S.D. Tex. 2003).

⁴⁵ “Exceptions to coverage must be interpreted as narrowly as possible in order to provide maximum coverage for the insured . . .” 43 AM. JUR. 2D *Insurance* § 313 (2003 & Supp. 2009).

⁴⁶ “The rule is well established that if exceptions, exclusions, exemptions from, or limitations of, the liability of an insurer not expressed plainly and without ambiguity, they will be construed strictly against the insurer, and liberally in favor of the insured, in order that the purpose of insurance shall not be defeated.” 43 AM. JUR. 2D *Insurance* § 313 (2003 & Supp. 2009).

several road blocks to successful recovery or indemnification. These providers will attempt to bar claims on their policies by asserting that the insured was a voluntary payer, the claim asserted was for an uncovered breach of contract, or the claim asserted does not fit the policy's coverage.

A. Voluntary Payer

When an E & O insurer asserts a voluntary payer defense, it is usually for two reasons: 1) the title insurer seeking recovery is not entitled to subrogation because he was a voluntary payer, or 2) the policy expressly provides that no payment will be reimbursed if made without tendering the claim to the insurer.

i. What is a Voluntary Payment?

In Virginia, the voluntary payment doctrine bars recovery for payment that is made: (1) under a mistake of law to another party claiming payment is owed, and (2) with full knowledge of the facts and circumstances.⁴⁷ “Where a party is not faced with imminent consequences and the party seeking to reclaim the payment has made the payment with full knowledge of the facts, Virginia considers such payments to be voluntary and unrecoverable in a later lawsuit.”⁴⁸ Full knowledge of the facts requires that the payer know material facts related to its obligation to pay.⁴⁹

In the case of a subrogation claim, a payment is not voluntary when:

⁴⁷ Williams v. Consolvo, 237 Va. 608, 613 (1989).

⁴⁸ Lamont v. Seabury, 64 Va. Cir. 243, 249 (Fairfax 2004) (citing Consolvo, 237 Va. at 616).

⁴⁹ See Amica Mut. Ins. Co. v. Liberty Mut. Fire Ins. Co., 72 Va. Cir. 154 (Loudoun 2006).

- 1) there is a reasonable or good faith belief in an obligation or personal interest in making the payment,⁵⁰
- 2) there is a “conventional subrogation” agreement between the party claiming a right to action (insurer) and the injured party (insured),⁵¹ or
- 3) the insurer is faced with an imminent loss or consequence, and payment is necessary to prevent said loss.

There are two views regarding subrogation in the case of insurers’ dispute over which insurer is responsible for the claim. According to some jurisdictions, where there is an interest in investigating and settling a claim, subrogation is permitted after the payment of a claim that was the subject of dispute between insurers as to which of them was responsible.⁵² However, some courts have held that when there is a question as to whether there is coverage, an insurer must wait for a court to adjudicate coverage.⁵³

ii. No Subrogation Due to Voluntary Payment

E & O providers may assert that the plaintiff title insurer is not entitled to subrogation of a claim because the title insurer voluntarily paid claims that were not covered by the title insurance policy.⁵⁴ This defense is primarily focused on the claimant making a mistake of law—

⁵⁰ *Encompass Insurance Co. v. Great Northern Insurance Co.*, 2005 U.S. Dist. LEXIS 18199, *2 (D. Mass. Aug. 25, 2005); *IAP Worldwide Services v. UTi United States, Inc.*, 2006 U.S. Dist. LEXIS 4766, *33 (E.D. Pa. Feb. 8, 2006).

⁵¹ *Continental Casualty Co. v. Fifth/Third Bank*, 418 F. Supp.2d 964, 971 (D. Ohio 2006) (would be bad public policy to force insurers to assert every possible defense against the insured) (citing *Commercial Std. Insurance Co. v. American Employers Insurance Co.*, 209 F.2d 60, 65 (6th Cir. 1954)).

⁵² *Westport Insurance*, 375 F. Supp.2d at 8.

⁵³ *Id.*

⁵⁴ *See First American Title Ins. Co. v. Cumberland County Bank*, 2009 U.S. Dist. LEXIS 345697, *30 (M.D. Tenn. Apr. 20, 2009).

“the right of recovery in subrogation does not exist for a mere volunteer.”⁵⁵ Where “one voluntarily pays money under a mistake of law, the payer may not ordinarily bring a common law action for the recovery of the money.”⁵⁶ This typically concerns the agreement between the title insurer and its insured. If the title insurer pays its insured for a claim that is not covered by the title insurance policy, the title insurer will not be entitled to subrogation of the insured’s claim against the settlement agent.

iii. Insurance Contract Bars Voluntary Payments

Although outside of the control of the title insurer, an E & O policy may bar recovery on the policy for the settlement agent’s failure to submit the claim to his E & O insurer before defending against the claim. The policy behind provisions barring reimbursement for voluntary payments, including defense costs, is to provide the insurance company the opportunity to examine the claim against the settlement agent for merit before paying on the policy.⁵⁷ Such provisions require the settlement agent to submit the claim to the insurance company. E & O providers will not generally reimburse any claims that are not submitted. A typical anti-voluntary payment clause provides:

No insured will, except at that insured's own cost, voluntarily make a payment, assume any obligation, or incur any expense . . . without our consent.⁵⁸

⁵⁵ *Winchester Homes v. Hoover Universal, Inc.*, 39 Va. Cir. 107, 117 (Fairfax 1996) (citing *Federal Land Bank v. Joynes*, 179 Va. 394, 402 (1942)).

⁵⁶ *Robinson v. Fountainhead Title Group*, 447 F. Supp. 2d 478, 493 (D.Md. 2006); *see also Stewart Title Co. v. Title Connection, Inc.*, 2005 U.S. Dist. LEXIS 42036, *11 (S.D. Miss. May 26, 2005) (citing *Genesis Ins. Co. v. Wausau*, 343 F.3d 733, 736 (5th Cir. 2003); *Wilkinson Homes, Inc. v. Stewart Title Guaranty Co.*, 610 S.E.2d 187, (Ga. Ct. App. 2005); *Westport Insurance v. St. Paul Fire & Marine Insurance Co.*, 375 F. Supp.2d 4, 8 (D. Conn. 2005) (where insurer paid claim not covered by insurance policy not entitled to subrogation).

⁵⁷ *See, e.g., Phillips Way Inc. v. Am. Equity Ins. Co.*, 795 A.2d 216, 220-21 (Md. Ct. Spec. App. 2002) (citing 7 COUCH ON INSURANCE § 105.7 (3d ed. 1997)).

⁵⁸ *French v. Assur. Co. of Am.*, 2006 U.S. Dist. LEXIS 74886 (E.D. Va. Oct. 16, 2006).

Some jurisdictions have upheld these provisions and the E & O provider has not been required to pay for defense costs incurred prior to submission of a claim.⁵⁹ In *Tradewinds Escrow*, the insured was not entitled to reimbursement of defense costs incurred prior to submitting the claim to the insurer for coverage.⁶⁰ The policy included a “no voluntary payments” clause.⁶¹ Regardless of whether the insurer was liable under the policy, the failure of the insured to tender the claim brought the expenses incurred outside of the terms of the policy.⁶²

Although generally upheld, there are a few exceptions to the voluntary payment defense. In the case of a no voluntary payments or no action provision, the insured is not in breach for making a voluntary payment if:

- (1) Defense has been tendered, but insurer denied coverage.
- (2) Insurer denies liability.
- (3) Insurer refuses to settle in bad faith.⁶³

Presentation to the insurer is needed for all three exceptions. These exceptions primarily turn on the insurer being presented with the claim, and then the insurer refusing to pay or defend on the policy.

⁵⁹ See *Tradewinds Escrow v. Truck Insurance Exchange*, 118 Cal. Rptr. 2d 561 (Ct. App. 2002); *French v. Assur. Co. of Am.*, 2006 U.S. Dist. LEXIS 74886 (E.D. Va. Oct. 16, 2006); *Nationwide Mut. Ins. v. Webb*, 436 A.2d 465 (Md. 2002); *Enodis Corp. v. Employers Ins. Co.*, 2007 U.S. Dist. LEXIS 97820, *32 (C.D. Cal. June 18, 2007); *Friedland v. Travelers Indem. Co.*, 105 P.3d 639, 642 (Colo. 2005)

⁶⁰ *Tradewinds Escrow*, 118 Cal. Rptr. 2d at 565.

⁶¹ *Id.*

⁶² *Id.*

⁶³ *French v. Assur. Co. of Am.*, 2006 U.S. Dist. LEXIS 74886 (E.D. Va. Oct. 16, 2006) (deciding based on Maryland law).

B. Breach of Contract Exclusion

Another common exclusion in an errors and omissions policy is for breach of contract, or other intentional conduct. A typical breach of contract exclusion eliminates coverage for:

Any damages for liability of others which the insured has assumed under any oral or written contract or agreement, except that this exclusion does not apply to liability for damages that the insured would have had in the absence of the contract or agreement.⁶⁴

This clause was successfully asserted by an insurance provider in *Northland Insurance Co. v. Stewart Title Co.*⁶⁵ In *Northland Insurance*, Stewart Title sought indemnification from Northland for Stewart Title's settlement agent's misappropriation of escrow monies, breach of the underwriting agreement and other tortuous conduct, including negligence. However, the errors and omissions policy specifically excluded coverage for: Breach of Contract, Criminal Acts, and Mishandling of Funds. Although Stewart pleaded negligence along with breach of contract, it was determined that the negligence relied on the breach of contract, thus it was not covered by the policy. Importantly, the duty breached in the asserted negligence was a duty created by the contract. Thus, where the duty exists through the contract and not otherwise, and the policy excludes coverage for breach of contract, the policy will not cover breach of the contract whether the breach was intentional or negligent.⁶⁶

However, this defense is not always successful, or even treated the same across jurisdictions.⁶⁷ In *Britamco Underwriters*, the defendant settlement agent had an insurance policy that excluded "any act, error or omission of the Insured committed with actual dishonest,

⁶⁴ *Northland Insurance Co. v. Stewart Title Co.*, 327 F.3d 448 (6th Cir. 2003).

⁶⁵ *Id.*

⁶⁶ *Id.* at 457.

⁶⁷ *See Britamco Underwriters v. Emerald Extract*, 855 F. Supp. 793 (E.D. Pa. 1994).

fraudulent, criminal or malicious purpose or intent."⁶⁸ A title insurance company brought a claim against the settlement agent for failing to handle settlement accounts according to required procedures. The errors and omissions insurer argued that because the complaint alleged intentional conduct, they had no duty to defend the insured settlement agent in the suit. Despite this argument, claims and facts as found in depositions indicated that the insured could be liable for either intentional or negligent misconduct relating to the handling of the escrow account, thus the court ruled that the insurer must defend under the policy insuring against professional negligence.⁶⁹ Similarly, although not in an E & O coverage context, in *Rex Title*, a title insurer sued one of its agents for failing to release a lien on a title.⁷⁰ Although the agent was operating pursuant to an agreement, because Maryland law recognizes an independent fiduciary duty of an insurance agent to his principal, the title insurer was allowed to seek remedy for negligence.⁷¹

Although *Northland Insurance*, *Britamco Insurance* and *Rex Title* involved allegations of breach of contract or intentional acts, the key difference between the two different outcomes is the underlying source of the duty violated. In *Northland*, the duty to pay the claim was created purely in contract—the settlement agent did not violate, or was not shown to have violated a common law duty owed to the plaintiff; whereas in both *Britamco* and *Rex Title*, the complaint asserted negligence under a common law duty, along with breach and intentional conduct. Where the policy does not cover violations for contract, if the violation also creates a cause of action in tort, the title insurer's claim may still be covered. Where an independent duty

⁶⁸ *Id.* at 795.

⁶⁹ *Id.* at 795-96.

⁷⁰ *Lawyers Title Insurance Corp. v. Rex Title Corp.*, 282 F.3d 292, 293 (4th Cir. 2002).

⁷¹ *Id.*

accompanies a contractual obligation, that independent duty gives rise to a tort action separate from an action in contract. The injured party has a choice of remedies.⁷²

C. Defalcation Claims

Where liability arises out of the criminal acts of the insured, most errors and omissions policies will not cover the claim. A typically excluded act is the settlement agent's or the agent's employees' defalcation. Defalcation is defined as "[misappropriation of] money in one's charge."⁷³ It is synonymous with embezzlement.⁷⁴ The policy in *Global Title Co.* contained such a clause. In *Global Title*, the policy excluded coverage under the following:

Any unauthorized act committed by any protected person that deprives the owner of the use of their funds.

Any unauthorized use of funds by any protected person.

Mixing client-funds with any protected person's funds.

The failure of any protected person to properly account for funds.

Criminal, Dishonest or Fraudulent Wrongful Acts or Knowing Violations of the Rights or Laws. We won't cover loss that results from any criminal, dishonest, or fraudulent wrongful act or any knowing violation of rights or laws committed by: The protected person, or Anyone with the consent or knowledge of the protected person.⁷⁵

Four separate civil suits were filed against Global Title and its owner Mary Smith alleging misappropriation and defalcation of client funds. Mary Smith was later indicted for and pleaded guilty to mail fraud and failure to file tax returns based on the same

⁷² *Augusta Mutual Insurance Co. v. Mason*, 274 Va. 199, 205 (2007); *Lawyers Title Insurance Corp. v. Rex Title Corp.*, 282 F.3d 292, 294 (4th Cir. 2002).

⁷³ BRIAN A. GARNER, *A DICTIONARY OF MODERN LEGAL USAGE* (Oxford 1990) available at <http://www.lexis.com>.

⁷⁴ BALLANTINE'S LAW DICTIONARY (3d ed. 1969), available at <http://www.lexis.com>.

⁷⁵ *St. Paul Fire & Marine Insurance Co. v. Global Title Co.*, 2006 U.S. Dist. LEXIS 86364, *3-5 (W.D. Kan. Oct. 16, 2006).

defalcations. The court ruled that Ms. Smith and Global Title were clearly not covered under the terms of the mishandling of client funds clauses, and the criminal conduct clause.⁷⁶

However, where an employee or partner of the settlement agent acts maliciously, the other partner may still be entitled to coverage under an errors and omissions policy for negligent failure to supervise.⁷⁷ In *Eigermann*, the insurance policy contained an innocent party exception for insureds not involved in the wrongdoing. Although the insurance policy excepted mishandling of client funds, and criminal acts, the monies taken were the buyer's (firm was representing the seller), and there was an exception to the exception for innocent insureds not involved in the wrongdoing.⁷⁸ Because the owner/insured was not involved, he was covered by the policy.

D. Material Misrepresentation on Application for Insurance

One of the most common grounds for denying coverage under any insurance policy involves the settlement agent filling out the insurance form incorrectly or in bad faith. In the marine insurance context, this requires *uberrimae fidae*, or the utmost good faith of the party seeking insurance.⁷⁹ Under the *uberrimae fidae* standard, the party seeking insurance has a duty to *volunteer* any information that may be material to the decision to insure.⁸⁰ Virginia, like most

⁷⁶ *Id.* at *16.

⁷⁷ *See* *Eigerman v. Mt. Airy Insurance Co.*, 1996 U.S. Dist. LEXIS 14942 (D. Mass. Aug. 30, 1996).

⁷⁸ *Id.*

⁷⁹ *See, e.g.*, *New York Marine & General Insurance Co. v. Tradeline*, 266 F.3d 112, 123 (2d Cir. 2002).

⁸⁰ *Id.*

states, has not adopted this doctrine to insurance contracts outside of the maritime context.⁸¹

Most states merely require a non-marine insurance—including E & O insurance—applicant to truthfully answer the questions asked of him.⁸² Failure to do so can result in rescission of coverage.

When seeking to rescind a policy for misrepresentation, there are generally two types of questions the party seeking coverage has answered: 1) direct questions, and 2) questions qualified by the statement “to the best of your knowledge,” or its equivalent. To rescind a policy for a misrepresentation to a non-qualified question, the insurer has the duty to demonstrate:

- 1) that the statement on the application was untrue, and
- 2) that the insurance company’s reliance on the false statement was material to the company’s decision to undertake the risk and issue the policy.⁸³

However, if the policy includes language indicating that statements are made “to the best of [applicant’s] knowledge,” then the insurer must demonstrate that the statements were knowingly false to obtain rescission.⁸⁴ Whether the question asked is qualified by the statement “to the best of your knowledge,” or not, the exact form of the question is critical in determining what duty, if any, the applicant has in answering the question.

⁸¹ Standard Life & Accident Insurance Co. v. Dewberry & Davis, LLC, 210 Fed. Appx. 330, 333 (4th Cir. 2006) (noting that Virginia had not yet decided whether to apply *uberrimae fidae* in the reinsurance context); *see generally* PXRE Reinsurance Co. v. Lumberman’s Mutual Casualty Co., 2004 U.S. Dist. LEXIS 9343, *6 (N.D. Ill. May 21, 2004) (*quoting* Albany Insurance Co. v. Anh Thi Kieu, 927 F.2d 882, 888 (5th Cir. 1991) (“Today the sole remaining vestige of the doctrine [of *uberrimae fidae*] is in maritime insurance law”); 43 AM. JUR. 2D *Insurance* § 457 (noting that several jurisdiction require affirmative misrepresentations to rescind an insurance policy) (2003 & Supp. 2009).

⁸² St. Paul Fire & Marine Insurance Co. v. Jacobson, 48 F.3d 778, 780-81 (4th Cir. 1995).

⁸³ Commercial Underwriters Insurance Co. v. Hunt & Calderone, 261 Va. 38 (2001).

⁸⁴ Minn. Lawyers Mutual Insurance Co. v. Hancock, 600 F.Supp. 2d 702 (E.D. Va. 2009) (citing Old Republic Life Insurance Co. v. Bales, 213 Va. 771 (1973)).

In *Mt. Airy Insurance Co. v. Milstein*, the insurer successfully rescinded the contract for a material misrepresentation on an attorney's application.⁸⁵ Milstein's application included a question asking if there were any circumstances he was aware of that would lead to future liability; he answered no.⁸⁶ However, at the time he was, as a settlement agent, involved in a mortgage "ponzi" scheme.⁸⁷ Despite the lack of claims asserted against Milstein, his knowledge of the "ponzi" scheme was considered a material misrepresentation to the question asked.⁸⁸

In another settlement agent matter, *Medmarc Casualty Insurance Inc. v. Reagan Law Group*, the insured's application included the question: "At this time, does any applicant know of any act, or omission, or circumstance that could *reasonably give rise* to a professional liability claim against any one of the following: the firm, any past or present attorneys in the firm, or any predecessor firm?"⁸⁹ The insured answered no.⁹⁰ However, there were discrepancies in the way the insured was handling her trust account. She was using her trust account in conjunction with her operating account to cover various expenses, and there were multiple occasions where checks drawn on the trust account were returned for insufficient funds.⁹¹ Although at the time of application, she had not been sued by a client for the "general disarray" of her trust account, her answer was a material misrepresentation on her insurance application.⁹²

⁸⁵ 928 F. Supp. 171 (D.Conn. 1996).

⁸⁶ *Id.* at 172

⁸⁷ *Id.*

⁸⁸ *Id.*; *Westport Insurance Corp. v. Gionfriddo*, 524 F. Supp. 2d 167 (D. Conn. 2007) (same).

⁸⁹ 525 F. Supp. 2d 1334 (N.D. Ga. 2007).

⁹⁰ *Id.* at 1336.

⁹¹ *Id.* at 1341-42.

⁹² *Id.* at 1342.

In *TIG Insurance v. Reliable Research*, the settlement agent's application required the applicant to list every lawsuit that had been filed against it in the last ten years.⁹³ The settlement agent listed one suit which did not result in an adverse judgment, but failed to list a suit filed against it five years earlier which resulted in a permanent injunction enjoining the insured from "preparing Deeds or other legal documents relating to the transfer of real estate . . . and that [the insured] . . . cease and desist the unlawful practice of law."⁹⁴ In support of their claim that this was a material misrepresentation, TIG included an affidavit from the underwriter which stated that she would not have issued the policy if the permanent injunction suit was listed.⁹⁵ Based on the affidavit, the court ruled that the misrepresentation was material, and TIG was entitled to rescission.⁹⁶

E. Other Defenses

i. Specific Service Requirements

Some insurance carriers have incorporated a provision into the policy that excludes settlement services not provided for a fee. However such a clause has been held void as against public policy in at least one jurisdiction.⁹⁷

ii. Exception for Damage to Property

Some insurance providers have attempted to exclude negligence claims against attorneys acting as settlement agents because the malpractice policy excludes coverage for damage to

⁹³ 334 F.3d 630 (7th Cir. 2003).

⁹⁴ *Id.* at 632-33.

⁹⁵ *Id.* at 636-37.

⁹⁶ *Id.* at 637.

⁹⁷ *See Fireman's Fund Insurance Co. v. Puget Sound Escrow Closures*, 979 P.2d 872 (Wash. 1999).

property. This was the case in *Coregis Insurance Co. v. Law Offices of Phillip S. DeCaro*.⁹⁸ In *Coregis Insurance*, the defendant was an attorney acting as a settlement agent. An action was brought against him for failing to record an easement in a land transfer. The insurer argued that this type of claim was not covered because the defendant's malpractice policy specifically excluded damage to property. The court held that the negligence was covered, and that the exclusion of damage to property does not include mere economic damage.⁹⁹

iii. Excluded Activities from Involvement in "Flipping Scheme"

Another exclusion recently encountered was in the context of involvement in a residential "flipping scheme." In *United Fire & Casualty Insurance v. Realty Title*, the settlement agent had an errors and omissions policy that specifically excluded "the actual or alleged improper participation by any insured in any 'flip transaction.'"¹⁰⁰ Within the policy period, the settlement agent, in a suit against several defendants for conspiring to obtain loans on inflated home values, was charged with negligent supervision, negligence, and breach of fiduciary duty among other claims. The settlement agent was not charged as a knowing participant in the flipping scheme. The court ruled in favor of the settlement agent. In doing so, the court focused on the inclusion of the word "improper." The court reasoned:

United's inclusion of the word "improper" in the Policy indicates that not all participation in flip transactions negates coverage. It necessarily follows that for an insured to improperly participate in a flip transaction, the insured must have knowledge of the flip transaction. Thus, limiting the exclusion to "improper" participation necessitates an allegation of scienter, or guilty knowledge, to fall within the exclusion. Otherwise, the use of "improper" would be surplusage.¹⁰¹

⁹⁸ 2000 Colo. J. C.A.R. 5661 (6th Cir. 2000).

⁹⁹ *Id.*

¹⁰⁰ *United Fire & Casualty Insurance v. Realty Title*, 2007 U.S. Dist. LEXIS 7745, *5 (W.D. Mo. Feb. 2, 2007) (unreported).

¹⁰¹ *Id.* at *12.

Thus, where an exclusion requires the insured to intend to do the excluded act, the complaint must plead an intentional act.

V. RECOMMENDATIONS

A. Give Notice of Claims

As noted above, a common reason for denying payment on an insurance policy is failure to give proper notice of claims made against the insured.¹⁰² This extends to claims made by title insurers against the settlement agent. In order to recover from the settlement agent's E & O policy, the insured has to be served with a claim, and then the insured must give proper notice of the claim served to his or her insurer. In some states, the party injured by the settlement agent's professional negligence can directly give notice to the settlement agent's insurer of claims against the agent.¹⁰³ This includes claims based on a right of subrogation.¹⁰⁴

States that allow an injured party or subrogee to assert a claim against a tortfeasor's insurer apply an "actual notice" standard under insurance policies. Under an "actual notice" standard, the E & O insurer need only know about claims against the settlement agent—it does not matter from whom the insurer received notice.

Other states do not follow the actual notice standard, and instead require that all claims follow procedures set in the insurance policy for coverage.¹⁰⁵ Although the Virginia Supreme Court has not directly decided this issue, the Court has demonstrated some skepticism of the

¹⁰² *Supra*, Part II, Section A pp. 7-10.

¹⁰³ *MCI L.L.C. v. Rutgers Casualty Insurance Co.*, 2007 U.S. Dist. LEXIS 59241, *16 (DATE) (citing N.Y. INS. LAW § 3420(a)(3)); *Thomas v. Atlanta Casualty Co.*, 253 Ga.App. 199, 203-04; 558 S.E.2d 432 (Ga. 2001) (citing GA. CODE ANN. § 33-7-15(c)); *Colonial Insurance Co v. Barrett*, 208 W.Va. 706, 711, 542 S.E.2d 689 (2000) (noting that allowing the injured party to give notice to the tortfeasor's insurer is a widely accepted rule); *Bailey v. Universal Underwriters Insurance Co.*, 258 Ore. 201, 216, 474 P.2d 746, 754 (1970); *Illinois Valley Minerals Corp v. Royal-Globe Insurance Co.*, 70 Ill. App. 3d 296, 388 N.E.2d 253 (3d Dist. 1979); *See generally* 44 AM. JUR. 2D *Insurance* § 1339 (2003).

¹⁰⁴ *Cf.* 44 AM. JUR. 2D *Insurance* § 1339 (West 2003 & Supp. 2009) (noting general right of third parties other than the injured to give notice to insurer).

¹⁰⁵ *See Id.* § 1339 n. 11.

“actual notice” standard.¹⁰⁶ In *Liberty Mutual Insurance Co.*, the at-fault insured failed to give notice to his insurer according to policy procedures. However, the injured party’s attorney gave notice to the insured’s agent who then gave notice to the insured’s insurer. The insurer stipulated that it received adequate notice. In noting the stipulation, the court commented that the insurer’s stipulation that notice passing from an attorney to an insurance agent and then to the insurer constituted notice under the policy was “a rather unusual position.”¹⁰⁷

B. Appoint a Receiver

In certain situations, when attempting to recover under an E & O policy, it may be necessary to petition the court to appoint a receiver for the settlement agent. Some agency agreements expressly provide for the right to appoint a receiver in certain circumstances. Still, appointing a receiver can be tremendously expensive, and depending on the case, may be prohibitively so. Appointment can be necessary because the settlement agent either refuses to tender the claim to his insurer, is physically unable to turn the claim over,¹⁰⁸ or there is a risk that the agent’s failure to cooperate with his insurer may result in cancellation of coverage. After being appointed, the receiver exercises dominion over the claim against the agent. Getting a receiver appointed, however, is not a matter of right—appointment is within the discretion of the court.¹⁰⁹ It is a power in equity that is usually only exercised as a last resort.¹¹⁰ To get a receiver appointed, the plaintiff generally must demonstrate two things: 1) a right or probable right to

¹⁰⁶ See *Liberty Mutual Insurance Co. v. Safeco Ins. Co.*, 223 Va. 317, 324 (1982).

¹⁰⁷ *Id.*

¹⁰⁸ *Mt. Airy Insurance Co. v. Thomas E. Angst & Assocs.*, 954 F. Supp. 1040 (E.D. Pa. 1997) (Receiver appointed where defendant insured died before claim was made).

¹⁰⁹ See, e.g., VA. CODE ANN. § 8.01-591 to -592; CAL. CODE CIV. PROC. § 564(9).

¹¹⁰ *Bethlehem Steel Corp v. Williams Industries*, 245 Va. 38 (1993).

specific funds or property, and 2) imminent danger of loss of the funds or property against which the plaintiff has a claim.¹¹¹

i. Probable Right to Funds

Establishing a right to specific property or funds is the first step in getting a receiver appointed. A plaintiff seeking appointment of a receiver must demonstrate that there is merit to his or her claims—in other words, “a reasonable probability of . . . success on the merits.”¹¹² This can be satisfied by showing a prima facie case of professional negligence against the settlement agent.¹¹³

Furthermore, the plaintiff must demonstrate a right to the specific funds in question¹¹⁴—it is not enough to merely demonstrate that the property in question is sufficient to satisfy the claim.¹¹⁵

ii. Imminent Danger of Loss

Finally, to get a receiver appointed, one must demonstrate an imminent danger of loss of the property in question.¹¹⁶ Although such loss can be demonstrated by a party’s failure to take action,¹¹⁷ it is not enough to demonstrate that the defendant is not making the most efficient use

¹¹¹ See, e.g., *McClanahans Adm’r v. Norfolk Ry. Co.*, 122 Va. 705 (1918); *Norris v. Lake*, 89 Va. 513 (1893); *Sult v. Hochstetter Oil Co.*, 63 W.Va. 317, 61 S.E. 307 (1908); *Rondos v. Superior Court*, 151 Cal.App. 2d 190 (3d Dist. 1957).

¹¹² 65 AM. JUR. 2D *Receivers* § 22 (2001 & Supp. 2009).

¹¹³ See *Norris*, 89 Va. at 518.

¹¹⁴ 15 M.J. *Receivers* § 7 (2009).

¹¹⁵ *Id.* § 15 (2009).

¹¹⁶ 65 AM. JUR. 2D *Receivers* § 31 (2001 & Supp. 2009).

¹¹⁷ *Id.* § 33.

of the property in question.¹¹⁸ In the context of a settlement agent's failure to tender a claim against him to his E & O insurer, one might argue that there is danger of loss of proceeds to satisfy the claim if the court does not appoint a receiver capable of making a claim against an E & O policy.

C. Require Specific Language in Errors and Omissions Policy

Another fundamental roadblock to recovery—the policy's language—can be easily adjusted to provide for recovery. Insurance policies are not one-size fits all. Although an attorney's malpractice insurance may provide adequate coverage for a thriving law practice, it may not provide coverage at all for the duties of a settlement agent. To ensure that the settlement agent can cover claims, title companies, pursuant to agreement, can require specific levels of coverage and specific language in the policy. One example may be to negotiate for the deletion of the "breach of contract" exclusion.¹¹⁹

VI. CONCLUSION

Regardless of which avenue a title insurer chooses to recoup funds from a settlement agent, there is a basic formula to follow. The title insurer must establish a duty to indemnify, a breach, and sufficient funds to cover the claim. This article explains how to establish such a duty, and how to ensure that proceeds would be available through an E & O policy. Although an E & O provider may assert various defenses, this article addresses ways to both plan for those defenses before a settlement agent's breach, and navigate around them after a breach. By following the guidelines in this article, one can greatly reduce a title insurer's risk of paying out a claim and not being able to recoup funds from a settlement agent's errors.

¹¹⁸ Union Mut. L. Ins. Co. v. Union Mills Plaster Co., 37 F. 286, 292 (W.D. Mich. 1889).

¹¹⁹ *Supra*, part IV, section B, pp. 17-19.