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AMERICAN LAND TITLE ASSOCIATION

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Title Insurance

Lawsuit to Determine Lender's Policy Loss Amount Filed Prematurely

Fidelity Nat'l Title Ins. Co. v. MidAtlantic Farm Credit, ___ F.Supp.3d ___, 2022 WL 374510 (D.Md. 2022) (permanent citation not yet available).

A Maryland court has dismissed a title insurer's declaratory judgment action as premature, because a lender's potential loss remains speculative until the lender takes title to the insured property.

Linda C. Bachenheimer Trevan bought 75 acres of land in Damascus, Maryland in 2004, for $1.6 million. Later, Linda and her husband Martin got a refinance loan of $1,280,000 from MidAtlantic Farm Credit ACA. Fidelity National Title issued a loan policy to MidAtlantic.

The property is governed by a 1980 master plan of development set by Montgomery County. Under that plan, some land in the vicinity was designated as Agricultural Reserve, on which the owner is allowed to build one residence for every 25 acres. However, the owner of Agricultural Reserve property can buy development rights from an owner of land in an area designated for more dense development.

The 75 acres that Bachenheimer Trevan bought had originally been permitted for up to 15 residences. The court describes each right to build a residence as a TDR. Prior owners conveyed away most of the development rights to the owners of Agricultural Reserve parcels. By 1983, the property retained the right to build only three residences. In 1986, with one house on the property, then-owners Michael and Barbara Cannizzo sold two of the TDR rights to the county by means of an easement. The 1986 easement said that "no additional single-family dwelling could be constructed on the Property."

The Trevan owner's policy and the MidAtlantic loan policy both recited in Schedule A that the property included three TDRs "relating to the parcel of land." It appears that neither policy reflected the effect of the 1986 easement by which the Cannizzos conveyed the last two unused TDRs.

In 2012, the county offered to buy the two unused TDRs from the Trevans for $472,500. The Trevans were interested, and responded to the offer by applying to the county for permission to sell the two TDRs. The county apparently investigated further. It replied that the Damascus property only had one TDR, and it rescinded its offer.

The Trevans made a claim to Fidelity under their policy for the claimed value of the two TDRs. Fidelity accepted coverage and filed suit, asserting that the property

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J. Bushnell Nielsen serves as editor. Please submit news and guest columns to **bnielsen@reinhartlaw.com**.

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had three TDRs. The circuit court ruled that the property had only one TDR when it was sold to Trevan.

This court said that, when that judgment was entered, Fidelity "acknowledged that erroneous property description which included the two TDRs 'constitutes a defect or encumbrance' on the title" that was covered by both policies. Fidelity engaged an appraiser to produce a diminution in value report. The appraiser opined that the property was worth $1,405,000 with only one TDR, and that the two additional TDRs would be worth $120,000.

Fidelity offered to pay $120,000. It would make the payment to MidAtlantic as a principal reduction on its loan. Condition 11 of the owner's policy says that a loss paid to a lender is also credited against the owner's loss amount.

The Trevans rejected the payment, contending that the value of the TDRs was more than $120,000.

Fidelity explained to MidAtlantic that, because the appraised value of the property in 2013 was more than the loan amount, "MidAtlantic was not reasonably likely to suffer any loss arising from the titling error," as the court phrased it. In January of 2018, MidAtlantic responded in a letter that asked questions about the TDRs and how Fidelity planned to deal with the claim under the owner's policy. The court says that Fidelity "apparently never responded to this letter." About two years later, Fidelity asked MidAtlantic to submit a proof of loss. MidAtlantic did not respond.

In 2021, Fidelity filed a declaratory judgment action against the Trevans and MidAtlantic. Fidelity asked the court to rule that the loss payable to the Trevans was $120,000, and that MidAtlantic had not suffered a loss. The Trevans answered the complaint and filed counterclaims. However, MidAtlantic moved to dismiss the claims against it. This decision was issued to decide that motion.

The court agreed with MidAtlantic that the issue of loss payable to the lender was too remote and speculative to confer standing, and that the claim was not ripe for review under the Maryland Declaratory Judgment Act. Under both the Maryland law and federal Article III standing principles, the plaintiff must show that "a sufficiently concrete dispute exists between the parties." *Jones v. Sears Roebuck & Co.*, 301 Fed. App'x 276, 282 (4th Cir. 2008) (per curiam) (unpublished opinion). If not, the court's ruling will be merely an impermissible "advisory opinion." *United Pub. Workers of Am. (C.I.O.) v. Mitchell*, 330 U.S. 75, 89 (1947).

Fidelity argued that MidAtlantic's 2018 letter constituted a claim under the loan policy that created a controversy. It argued further that MidAtlantic's failure to deliver a proof of loss meant that the claim was still pending and in need of resolution. The court disagreed, saying:

> …[T]he January 2018 letter simply does not constitute a claim for coverage such that a substantial, ongoing controversy exists between the parties today. For one, the letter is four years old, and although it is styled as an insurance "claim," nowhere does it set out how or if the titling error resulted in MidAtlantic having sustained a loss covered under the Loan Policy. While a claim made for insurance coverage may be sufficiently concrete and imminent to confer standing, Fidelity has generated no facts to make plausible that MidAtlantic has filed any such "claim." See, e.g., *Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Hicks, Muse, Tate & Furst, Inc., No. 1334 (SAS), 2002 WL 1482625, at *4 (S.D.N.Y. July 10, 2002)* ("At the very least, there must be a claim against the insured to give rise to an anticipatory lawsuit by a liability insurance carrier."). And the mere passage of time without any additional request from MidAtlantic for coverage under the Loan Policy renders speculative at best that a "substantial and ongoing" controversy exists between the parties based solely on the January 2018 letter.

The court also said that Fidelity's own position that MidAtlantic may never incur a loss due to the "titling error" undercut its assertion that there was a dispute that the court could resolve. It said:

> Fidelity points solely to the appraisal as to the Property's value in 2013 and asks this Court to infer that this appraisal alone demonstrates MidAtlantic has no covered loss under the Loan Policy. This is speculative at best. A 2013 valuation cannot predict the future damages or losses that MidAtlantic may face

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because of the title defect. It is undisputed that MidAtlantic still holds the loan secured by the Damascus Property and its attendant titling error. Contrary to Fidelity's insistence…, no court can reasonably forecast when or if MidAtlantic may ever need to foreclose on the Property to satisfy the loan; nor can it divine if any future sale would be hampered by the historic titling defect. Stated otherwise, no facts make plausible that Fidelity can cabin all possible future events that may trigger coverage under the Loan Policy and also limit the scope of recovery based on a single historic appraisal. "[F]ederal courts are not in the business of opining on such hypothetical scenarios that may never come to pass." See *Allstate Ins. Co. v. Preston*, No. JKB-19-0429, 2019 WL 3067918, at *4 (D. Md. July 12, 2019).

This decision illustrates the difficulties in navigating the contours of policy coverage when an owner has suffered a loss but a lender has not. Some courts have held that a suit to determine the amount of a lender's loss is premature when the lender is not yet in title. See, for example, *Green v. Evesham Corp.*, 179 N.J.Super. 105, 430 A.2d 944 (1981), *CMEI, Inc. v. American Title Ins. Co.*, 447 So.2d 427, 428 (Fla.App. 1984), and *Falmouth National Bank v. Ticor Title Ins. Co.*, 920 F.2d 1058 (1st Cir. 1990). Also, a title insurer can make a payment to the lender under Condition 11 of the owner's policy whether or not the insurer believes that the lender has suffered a loss. Condition 11 says that "the amount so paid shall be deemed a payment to the Insured under this [the owner's] policy." The insured owner receives the full benefit of the loss payment, by the reduction in loan principal owed.

This decision also highlights a pitfall that exists when an insured owner disputes the amount of the loss. The insurer should view the loss as having two components—the undisputed portion, and the disputed or speculative additional loss as claimed by the insured. Many insurance codes require the insurer to promptly pay the undisputed loss amount. Once that payment has been made, the burden shifts to the insured to establish a loss in some amount greater than what the insurer has paid. Thus, the insurer should resist the insured's objection to the insurer's payment of the undisputed loss amount, which is a trap for the unwary. Fidelity could have insisted on paying the $120,000 to MidAtlantic and thereafter invited the Trevans to prove that the appraised diminution was not the full loss payable.

Finally, the decision also highlights an important issue about nomenclature. The ALTA policies continue to use the phrase "loss or damage" when referring to the loss payable under the policy. The correct term is loss. No "damage" is payable under a contract for insurance. Damage is a tort principle. Further, the term damage typically applies to bodily injury or harm to property due to a deliberate act or peril, which are not the subjects of a title insurance policy. Thus, the title insurer will always do well to refer to loss, and only loss, when discussing payment of indemnity.

Title Insurance

Court Suggests That Georgia Bad Faith Statute Sets Deadline for Title Clearance

May v. Old Republic Nat'l Title Ins. Co., ___ F.Supp.3d ___, 2022 WL 402216 (M.D.Ga. 2022) (permanent citation not yet available).

A Georgia court has said that a bad faith claim against a title insurer survives dismissal because the insurer did not remove a lien within 60 days of receiving a demand from the insured.

Bruce May bought a house in Ellerslie, Ga., on Nov. 9, 2018. A federal tax lien of $140,906.29 was recorded four days earlier, on Nov. 5. The court says the lien attached to the property. The court states that May did not know about the lien when he closed, and "the lien was not accounted for in May's purchase price."

May bought a policy from Old Republic National Title. May learned of the tax lien in the course of selling the house in 2020. May alleges that the planned closing was cancelled due to the lien. May's lawyer informed Old Republic of the lien before the closing was cancelled. After the sale was called off, May submitted a policy claim notice. He asked Old Republic to pay off the lien so that he could sell the house.

Old Republic's representative said that he was "not sure why it's a problem, ... since you have coverage for it." May's lawyer then sent Old Republic more information about the lien. On Jan. 5, 2021, Old Republic issued a coverage determination. It said that, although the tax lien "appears to present a covered matter, ... you are currently not suffering a loss which would trigger coverage" because the IRS had not threatened to levy on the house. Old Republic reiterated its coverage position in a second letter.

On Jan. 20, 2021, May sent a demand letter asking Old Republic to pay and cure the lien within 60 days. Old Republic responded to that letter by agreeing to remove the lien. May alleges that Old Republic "did not hire a title service professional to clear the lien until the end of the sixty-day period provided by May's letter." Old Republic removed the lien on April 6, 2021.

May sued Old Republic under Georgia's bad faith insurance statute, O.C.G.A. § 33-4-6. Old Republic moved to dismiss the complaint, arguing that May did not suffer a covered loss under the insurance policy and that Old Republic did not act in bad faith. In this decision, the court denied the motion, finding that May had alleged sufficient facts to establish the elements of a plausible bad faith claim.

Under Georgia's bad faith statute, the insured must prove three elements: that his or her claim is covered by the policy, that the insured made a demand for payment at least 60 days before the action was

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filed, and that the insurer's failure to pay was motivated by bad faith. This court cited two prior title insurance decisions construing the statute, *Lawyers Title Ins. Corp. v. Griffin,* 691 S.E.2d 633 (Ga.App. 2010), and *BayRock Mortg. Corp. v. Chicago Title Ins. Co.*, 648 S.E.2d 433 (Ga.App. 2007).

Old Republic asserted that it did not act in bad faith because it always acknowledged coverage, took action to clear title, and did in fact clear title so that the insured suffered no loss. The court responded that Old Republic "had a duty to clear the lien in a reasonably diligent manner."

May argued that the Georgia law sets a 60-day time limit for clearing title, and that "no reasonable justification existed for" Old Republic's "delay" in clearing title. He emphasized that most of the 60-day period had expired before Old Republic retained counsel to remove the lien. He also hammered that "over 100 days" elapsed from his first inquiry to Old Republic's office to the date on which the lien was removed.

The court said May had alleged enough to survive dismissal:

> May has sufficiently alleged that Old Republic did not act in a reasonably diligent manner in clearing the lien. As to his damages, May has alleged that the existence of the lien required him to postpone his sale of the property. Although he may not have suffered a diminution in the sales price after the lien was eventually removed, May alleges that the delay caused additional damages, including extra utility and mortgage costs. May has adequately alleged a covered claim under the policy, an unreasonable failure by Old Republic to timely comply with its obligations under the policy, and damages arising from that failure.

The court also held that May had adequately pled that Old Republic acted in bad faith, by alleging that the insurer "repeatedly refused to resolve the lien despite agreeing that May's claim was covered." May also alleged that Old Republic said "it would not resolve his lien because the IRS was not taking action on the lien despite the insurance policy containing no such exclusion."

There are several tactical lessons embedded in this decision. First, the court is correct that watchful waiting is not found in the ALTA policy's terms. Thus, the insurer must explain at length how that coverage response works—that the claim is covered, and is not being denied, but that no action is required until the lien holder takes action to enforce the lien. Watchful waiting does not mesh well with state laws requiring that an insurer pay covered claims within a certain time after the claim notice and proof of loss have been delivered.

Second, watchful waiting can be perilous when the title issue is discovered while the property is for sale. In many cases, a better response is to inform the insured of the actions the insurer will take to assist the insured in selling the property, including to protect the purchaser from the title issue.

Third, watchful waiting is appropriate when a lien will expire in the near future or there is a viable basis on which to assert that the lien does not attach. It helps to explain to the insured that the reason the insurer will not take action to remove a lien is because it does not attach, or will soon expire as a lien. This decision gave few facts about the lien on the May property other than that it was recorded four days before May closed on his purchase. That one fact suggests that the tax lien may not have attached under the doctrine of equitable conversion. Under that doctrine, equitable title vests in a purchaser when he or she has waived all contingencies and holds an unconditional contractual right to buy the property. A lien recorded against the seller after equitable conversion has occurred does not attach to the title. See *Mueller v. Novelty Dye Works*, 273 Wis. 501, 78 N.W.2d 881 (1956), *Hamilton v. Rottenberg*, 2020 WL 5092823 (Md. Sp.App.) (unpublished), *State Farm Gen'l Ins. Co. v. Stewart*, 224 Ill.Dec. 310, 681 N.E.2d 625 (1997), and the other decisions discussed in Nielsen, *Title and Escrow Claims Guide*, American Land Title Association, 2022 Edition, at section 3.4.7.1.3, *Interest Existing Before Attachment Of Lien*.

Title Insurance

Driveway Encroachments Do Not Invoke Access Coverage

Pierot v. Chicago Title Ins. Co., 159 N.Y.S.3d 729 (Mem), 2022 N.Y. Slip Op. 01057 (N.Y.A.D. 2 Dept. 2022) (permanent citation not yet available).

When the insured property directly abutted a public road, and contained an exception for the encroachment of the insured's driveway onto the neighboring parcel, the insurer was not obligated to defend the insureds in litigation with their neighbor over the status of a second road and ownership of the encroaching part of the driveway.

Audrey Pierot and Mark Gordon bought a home in the Town of Greenburgh, Westchester County, New York, in 2001. The parcel abuts Healy Avenue. A driveway on the parcel also connects to nearby Elizabeth Street. Part of that driveway runs over a triangular lot to the north. The two lots were formerly one; the prior owners caused the lot split.

When Pierot and Gordon bought their house in 2001, the triangular lot to the north was vacant. Michael and Naomi Marom bought the vacant north lot in 2009 and began building a house there. A dispute ensued between the neighbors about the driveway, which spawned seven lawsuits. In 2014, Pierot and Gordon settled with the Maroms about all of the lawsuits, one aspect of which was payment of money to the Maroms in exchange for an easement for that part of the driveway that lies on the Marom lot.

In 2015, Pierot and Gordon sued Chicago Title, asking it to pay the attorneys' fees they had incurred in the lawsuits and to reimburse them for the settlement money they had paid. The insureds justified their claim, at least in part, on the fact that the Maroms had claimed to own part of Elizabeth Street, which is a private road. The insureds argued that this claim rendered

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the insured parcel landlocked, invoking the right of access coverage. They also argued that a marked-up title commitment indicated that the policy was supposed to affirmatively insure an access right onto Elizabeth Street, although that alleged coverage was not carried forward into the policy.

When discovery was complete, Chicago Title moved for summary judgment. It said that the access coverage was not invoked, even if there was doubt about the right to travel to Elizabeth Street, because the insured parcel directly abuts Healy Avenue. Second, the insurer said, it had no duty to defend or indemnify the insureds as to the use of that portion of the driveway that traveled over the Marom parcel because of two policy exceptions. Exception 2 was for "driveway encroaching 6'6" onto adjacent parcel north of northerly record line and onto Elizabeth Street," as shown on a survey. Exception 4 stated, "[n]o title is insured in and to so much of the driveway that encroaches the north as shown on the survey… ."

In October 2018, the supreme (trial) court agreed with Chicago Title, and granted summary judgment. In this decision, the appellate division affirmed.

The appeals court agreed that Healy Avenue gave a right of access. The court relied on *43 Park Owners Group, LLC v. Commonwealth Land Tit. Ins. Co.*, 121 A.D.3d 937, N.Y.S.2d 148, for the rule that the coverage is satisfied if the parcel abuts a street, even if the grade of the property makes such access difficult. The court also ruled that the exceptions negated any coverage for the disputed right to travel over the driveway located on the Marom parcel. It relied on *Melamed v. First American Tit. Ins. Co.*, 190 A.D.3d at 726, 135 N.Y.S.3d 874, for the proposition that an exception negates coverage for the matter described in the exception.

The one issue that the trial court addressed that was not discussed by the appellate division was the claim that the mark-up indicated an intended affirmative access right to Elizabeth Street. The trial court said this argument failed for two reasons:

> First, paragraph 15 of the conditions set forth in policy provides that the policy is the only contract between the parties (thus nothing set forth in the title commitment is part of the contract), and paragraph 4 of the exceptions to coverage in the policy excepts coverage of that portion of the driveway which encroaches on Elizabeth Street. Second, paragraph 13 of the title commitment states "[n]o title is insured in and to so much of the driveway that encroaches premises to the north as shown on the survey recited herein." Thus, both the commitment and the policy excepted the driveway encroachment onto Elizabeth Street from coverage.

Chicago Title was ably represented by Jeffrey R. Metz and Jaclyn Halpern Weinstein of Adam Leitman Bailey PC in New York.

Escrow Matters

Texas Court Rules on EB-5 Immigration Escrow

Lin v. Veritex Community Bank, N.A., ___ F.Supp.3d ___, 2022 WL 510483 (S.D.Tex. 2022) (permanent citation not yet available).

The would-be immigrant is the loser in a Texas lawsuit contesting the escrowee's delivery of the immigrant's money after it was deposited as part of a visa application under the United States Citizenship and Immigration Services EB-5 program.

Yuqi "Richard" Lin is a Chinese national who applied for an EB-5 visa, which would allow him to become a lawful permanent resident of the United States. The EB-5 program is premised on the applicant's investment of $500,000 or more in a business that has promised to create new American jobs.

Lin invested his money in RG Opportunities I LP, a limited partnership that solicited investments from Chinese people seeking EB-5 visas. RGO claimed it would run a chain of Brazilian barbecue restaurants.

RGO signed an escrow agreement appointing Veritex Community Bank NA, to hold the money deposited by Lin and the other investors. The Escrow Agreement referred to the visa applicants as Subscribers. Each subscriber invested in units of $500,000, referred to in the escrow agreement as the Subscription Proceeds. Lin was a Subscriber, but he was not made a party to the escrow agreement. New City Advisors LLC served as the Subscriber Representative, and was responsible for representing the interests of all the RGO investors, including Lin.

The escrow agreement recited the conditions for release of the money to RGO. Veritex was authorized to release $125,000 of the subscriber's $500,000 total when the subscriber had submitted an 1-526 visa petition. The trigger for that release was a notice sent by RGO and New City. When two investors' I-526 petitions were approved, Veritex was authorized to release to RGO an additional $325,000 from each of the approved investors. Again, that notice was to be sent by RGO and New City.

Lin was the first RGO investor to have his visa application approved. Although the escrow instructions said that Veritex would send no money to RGO until two visas had been approved, RGO and New City sent a notice to Veritex to release Lin's money as soon as his visa was approved. The bank sent the money.

RGO "misspent" the money, and Lin suffered a total loss.

Lin sued Veritex Bank for breach of contract and breach of fiduciary duty. The bank brought a third party complaint against RGO and New City. After discovery, the parties filed motions for summary judgment. The court dismissed a number of claims based on those motions.

Because of the way the escrow agreement and partnership were structured, Lin's first significant hurdle was proving that he had standing to bring suit. Article III of the federal constitution requires a plaintiff to "demonstrate injury in fact that is fairly traceable to the defendant's conduct and that would be redressed by a favorable judicial decision." See *NiGen Biotech, L.L.C. v. Paxton*, 804 F.3d 389, 396 (5th Cir. 2015), and *Lujan v. Defenders*

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of Wildlife, 504 U.S. 555, 560 (1992).

Veritex argued that Lin had not suffered an injury in fact that was fairly traceable to what the bank did, because the money belonged to the partnership, not to Lin. Veritex said that Lin gave his $500,000 to RGO in exchange for a partnership interest, so Lin held a proportionate share of RGO's assets. According to Veritex, Lin lost his money not because of the escrow but because the RGO business had died and the partnership was insolvent.

Lin responded that Veritex mishandled Lin's money when it was his property, not that of the partnership, and that his injury was redressable because RGO still exists and he could receive a permanent resident visa if he recovered the $375,000 and reinvested it in RGO before 2023.

Texas law says that a partner has constitutional standing to sue for an alleged loss in the value of his interest in the partnership. However, the court said, Lin had not argued that he lost the value in his partnership interest. Although Lin said he brought the suit "for the benefit of the partnership and other partners," his injury was based only on the money he invested in the partnership. Lin relied on *In re Fisher*, 433 S.W.3d 523 (Tex. 2014), in which the Texas Supreme Court recognized that "a partner who is 'personally aggrieved' may bring claims for those injuries suffered directly." In *Fisher*, the court concluded that at the motion to dismiss stage, it was sufficient that a partner alleged personal damages unique to him, such as "loss of earning capacity, lost profits, loss of income, damage to credit reputation, lost investments," injury to his character, and mental anguish.

The court held that Lin has not shown that he suffered an injury based on the early disbursement of his investment to RGO, and thus he lacked Article III standing to sue. The court's ruling was based on the questionable premise that the money did not belong to Lin while held in escrow. The court said:

> The record evidence shows that the $375,000 investment that was prematurely released to RGO was identified as Lin's investment by New City and RGO, and that Lin was relying on this investment to qualify for the I-526 visa. Lin provided this investment in exchange for his partnership interest. Although the investors, and not RGO, were responsible for taxes and earnings while the funds were in escrow, Lin has pointed to no evidence that he, rather than the partnership, owned the funds. Indeed, the purpose of this arrangement was for the partnership to use the funds to create jobs, not for the individual investors to make a profit. Lin would have been entitled to a refund if his petition was denied, but that cannot be the basis for his injury. His I-526 petition was approved in February 2017.
>
> Lin argues that he "lost" his investment, but he continues to own the partnership interest that he paid for. It may not be worth anything, but that is a different issue. Lin has not pointed to any evidence showing that he suffered a personal monetary loss that is different from the partnership's loss, like the injuries in *Fisher*. The record shows that Lin's investment was intended to be the partnership's property, and that the partnership would have received the funds even if they had not been prematurely disbursed. Any suggestion that Lin suffered a personal loss from this disbursement is speculation.

The court held that, even if Lin had had standing, he could not prove that he was harmed by Veritex's premature delivery of Lin's money to RGO:

> Lin's only alleged loss is his investment in RGO, but he has not provided or pointed to any evidence to show that he, rather than the partnership, suffered a loss from the alleged misuse of this money. Lin has not shown a genuine factual dispute material to determining his damages, and therefore Veritex is entitled to summary judgment on Lin's breach of contract claim.

The court also addressed Veritex's motion for summary judgment, on its claim that RGO had a duty to defend Veritex against Lin's claims. Section 6(d) of the Escrow Agreement said that RGO:

> agrees that in the event any controversy arises under or in connection with this Agreement or the Subscription Proceeds or [Veritex] is made a party to or intervenes in any litigation pertaining to this Agreement or the Subscription Proceeds, to pay to the Escrow Agent reasonable compensation for its extraordinary services and to reimburse the Escrow Agent for all costs and expenses, including legal fees and expenses, associated with such controversy or litigation.

Section 6(g) said that RGO and New City "jointly and severally agreed to indemnify [Veritex] ... against all Claims ... and Losses ... incurred by [Veritex] as a result of or in connection with [Veritex's] serving the capacity of escrow agent under this Agreement." RGO and New City agreed to "assume the investigation and defense of any Claim," and "to pay the costs and expense thereof, to employ separate counsel with respect to any such Claim."

Veritex had demanded that RGO defend the bank in the Lin action. RGO did not respond. RGO had admitted that the lawsuit pertained to the Escrow Agreement. The main defense raised by RGO was the provision in the Escrow Agreement stating that the indemnification right did not apply to disputes caused by Veritex's own gross negligence or willful misconduct. However, RGO had not alleged any gross negligence, and the disbursement was made based on a notice signed by RGO.

RGO also argued that the indemnification provision was illusory because "if RGO must indemnify Veritex, Veritex has no obligation to comply with the Agreement." The court said the clause did not render the escrow agreement illusory, especially since the bank was still liable for its own gross negligence or willful misconduct. Thus, the court concluded that RGO had a duty to pay for Veritex's defense of the Lin action.

Escrow Matters

EB-5 Visa Applicants Share Equally in Remaining Escrowed Money That Was Not Segregated

U.S. Bank, N.A. v. Quartzburg Gold, LP, ___ F.Supp.3d ___, 2022 WL 168585 (W.D.Wash. 2022), appeal filed February 22, 2022.

A Washington court has ruled that the money remaining in escrow under the Quartzburg Gold EB-5 visa program must be delivered to all of the depositors pro rata, because the money was not segregated while held in escrow.

The sordid story of the EB-5 immigration investor program run by Quartzburg Gold LP and Idaho State Regional Center LLC was explained in articles appearing in the April, 2020 and February 2021 issues of this newsletter. In brief, 29 Chinese nationals invested $500,000 each with Quartzburg Gold as investments that would qualify them for American EB-5 visa applications. The money was to be held in escrow by U.S. Bank while the visa applications were pending.

Sima (Serofim) Muroff was the principal of Quartzburg Gold, Idaho State Regional Center, Blackhawk Manager and ISR Capital. In 2017, the SEC sued Muroff, alleging that he had raised more than $140 million from Chinese nationals seeking EB-5 visas through Blackhawk Manager and ISR Capital and had mishandled some of the money. Muroff told the applicants that their money would be used to buy and develop luxury real estate in McCall, Idaho and in gold mining in Idaho and Montana. The SEC alleged that Muroff misspent more than $5 million of that money in a zip line course, two fancy houses, a Range Rover and a BMW. Muroff and his bookkeeper, Debra L. Riddle, agreed to pay about $700,000 to settle the SEC action. See Serofim Muroff, et al. (Release No. LR-23818; Apr. 28, 2017) (sec.gov).

The Chinese nationals sued U.S. Bank for having released their money from escrow prematurely, before their visas had been granted. The earlier newsletter articles reported on two non-final decisions issued in that case, *Chi Chen v. U.S. Bank, N.A.*, Case No. C16-1109-RSM. See 2020 WL 1031133 (W.D.Wash. 2020), and 507 F.Supp.3d 1254 (W.D.Wash. 2020).

Through discovery in the *Chen* action, the counsel for what the court calls the Huang Defendants learned that there was still money in the U.S. Bank escrow account. The Huang Defendants demanded the return of their money. U.S. Bank filed this interpleader action, asking the court to determine "how it should distribute the Huang Defendants' money." The court gave its instructions in this decision.

Quartzburg argued that the applicants who had delivered the money could not prove that the money had been segregated while in escrow, so that the money should be distributed pro rata. It cited *United States v. Real Property Located at 13328 and 13324 State Highway 75 N.*, 89 F.3d 551 (9th Cir. 1996)) and other authorities. Quartzburg based its position on the opinion of the "Independent Monitor" appointed in the SEC action that the investor money was not aggregated in the escrow account, and had been paid to Quartzburg "without being attributed to any specific investors."

The Huang Defendants claimed that the money had been segregated and that the remaining money could be traced solely to them. They presented an affidavit of a U.S. Bank officer that the bank tracked deposits into the escrow and disbursements from the account by the investors' names. They argued that their facts were in line with *S.E.C. v. Path America, LLC*, 2016 WL 1385144 (W.D.Wash. April 6, 2016), which held that investors were entitled to the return of their money when an EB-5 business failed because the money was directly attributable to certain investors and was segregated.

The court sided with Quartzburg, and held that the Huang Defendants had not proven that their money was segregated. It said:

> The records appear to show U.S. Bank's recordkeeping of who put money in and who requested refunds, but insufficient evidence as to whose money was actually being distributed in any given distribution to Quartzburg. The funds were essentially comingled. This is supported by the investigation and conclusions of the independent monitor from SEC v. Muroff, *et al., supra*. Even if the Huang Defendants had submitted adequate evidence that these remaining funds were tracible to their investment, the Court is convinced that this case is factually distinct from *Path America* and that equity would demand pro rata distribution under the line of cases cited in Quartzburg's briefing. The Court finds that allowing these individuals to receive their funds, previously comingled with the other investors and relied on by the Huang Defendants for the benefit of obtaining EB-5 visas, is not supported by case law and would be akin to allowing "one fraud victim to recover all of his losses at the expense of other victims" based solely on luck.

Escrow Matters

Texas Has Jurisdiction Over People Paid From Texas Escrow

Capital Title of Texas, LLC v. Shank, 2022 WL 480253 (Tex.App.-Corpus Christi) (unpublished).

Two brothers who received excess payment from an escrow conducted in Texas may be sued in Texas because they signed documents under which they joined the sale transaction and the escrow.

Carolyn Shank decided in 2019 to sell a second home in Alamo, Texas, that she had owned with her late husband Robert Shank Senior. Robert had bequeathed sole ownership of the home to Carolyn in his will, but Carolyn decided not to have the will probated. That meant that, under Texas intestacy law, Robert's four children from his first marriage received a half interest in the house. Carolyn lived in Kansas. None of the children lived in Texas either.

Carolyn signed a contract to sell the house. The buyer and seller hired Capital Title of Texas to issue a policy to the buyer and to conduct the sale escrow. Capital Title contacted the four children, asking them to sign deeds and to give instructions on how their shares of the sale proceeds should be delivered.

David and Robert Junior told Capital Title to pay their shares to Carolyn. For reasons that the court said were in dispute, Capital Title sent David and Robert Junior's shares to their siblings, Douglas and Mark, rather than to Carolyn. After escrow closed, Capital Title told Douglas and Mark that they had received their brothers' shares by mistake, and asked them to either return the money to Capital Title or pay it directly to the brothers.

Douglas and Mark refused. Carolyn, David and Robert Jr. sued Capital Title in Hidalgo County district court, alleging that it breached its duties as escrow agent. Capital Title filed a third-party petition against Douglas and Mark for unjust enrichment, to avoid having the court make the title agency pay sale proceeds from its own pockets that should be disgorged by the people who received that money.

Douglas and Mark reside in Louisiana and Kansas, respectively. They filed a combined special appearance and affidavits contesting the Texas court's jurisdiction over them. The court granted the special appearances without making any ruling as to jurisdiction. Capital Title appealed. In this decision, the appeals court held that the court had jurisdiction over Douglas and Mark.

Under Texas's long-arm statute, Texas courts may exercise personal jurisdiction over a nonresident defendant that "does business" in Texas. See Tex. Civ. Prac. & Rem. Code Ann. § 17.042 and *PHC-Minden, L.P., v. Kimberly-Clark Corp.*, 235 S.W.3d 163 (Tex. 2007). The state follows federal due process principles in determining if a person has had the required minimum contacts with the state to support personal jurisdiction. The test is that the state has personal jurisdiction if the "nonresident defendant purposefully avails itself of the privileges and benefits of conducting business in" Texas. *Moncrief Oil Int'l, Inc. v. OAO Gazprom*, 414 S.W.3d 142, 150 (Tex. 2013), quoting from *Retamco Operating, Inc. v. Republic Drilling Co.*, 278 S.W.3d 333, 338 (Tex. 2009)). Conversely, "random, isolated, or fortuitous contacts" do not prove that the defendant purposefully availed himself of the forum.

Capital Title argued that Douglas and Mark conducted business in Texas by communicating with Capital Title about the home sale by email and telephone, receiving the money from Capital Title, incurring tax obligations in Texas as part of the sale, and by signing and returning the warranty deed, seller proceeds instructions and 1099-S forms to Capital Title. Douglas and Mark argued that they had had no contacts with Texas. They pointed out that they became part owners of the house by operation of law, and they did not sign the contract to sell the property or the closing statement.

The court agreed with Douglas and Mark that the court did not obtain personal jurisdiction over them by their inheritance of interests in the house. The court said that they passively acquired interests in the property in a way that "could be described as fortuitous." It cited *Johnson v. Kindred*, 285 S.W.3d 895, 902 (Tex. App.—Dallas 2009, no pet.), which held that a trust beneficiary did not purposefully avail himself of the privileges of transacting business in Texas by the fact that the trustee decided to buy Texas property, because the beneficiary was merely a "passive investor" in the real estate.

The court also agreed that the purchase contract and escrow did not subject Douglas and Mark to personal jurisdiction, since they did not sign those contracts or arrange for the house to be sold.

However, the court said that, "by signing the deed and accepting the proceeds, the brothers made a purposeful decision to avail themselves of Texas law and profit from their ownership interests in Texas real property." Texas law controlled who inherited the property on Robert Senior's death. Douglas and Mark got their interests under that law. Thus, they benefitted from the Texas law. Also, the emails showed that Douglas and Mark "were deliberate in their decision to join the transaction." They reviewed the settlement statement, their father's will and deeds in the chain of title before they signed the deed. After all of that analysis, they reported to Capital Title that they were "ready to move forward with signing the documentation." The court noted that the brothers could have avoided Texas jurisdiction by quit claiming or disclaiming rights in the house. Instead, they joined the transaction and shared in the rewards. The court said that, "by choosing to participate in the transaction, Douglas and Mark purposefully availed themselves of the privileges and benefits of conducting activities in Texas."

The court also found that it would not be unduly burdensome for either brother to be involved in a Texas lawsuit, because they live not too far away from Texas and modern transportation makes it easier to travel there. Further, the claims of the other parties would necessarily be decided by the Texas court, making one combined suit more efficient.

This is a good decision. It is not uncommon for an escrow company to have to prevail on a remote person to solve a problem caused by an error in the distribution of seller proceeds. It would be very expensive to have to bring such an action in the state in which that person lives.

Escrow Matters

Escrow Principal Can Sue for Unauthorized Delivery of Loan Money to Borrower

Henley Finance, Ltd. V. Goyette & Associates, Inc., ___ F.Supp.3d ___, 2022 WL 597698 (E.D.Cal. 2022) (permanent citation not yet available).

A business lender's claims against the loan escrowee for delivering the money to the borrower without authority are not blunted by the escrowee's argument that no harm was done because the money was supposed to go to the borrower sooner or later.

Henley Finance, Ltd. is a company based in England and Wales. Henley agreed to make a short-term loan to Bioscience Enterprises Inc., a Delaware company doing business in the CBD and hemp trade in California. The loan agreement set the loan term at no more than 60 days after Bioscience received the loan money.

Goyette & Associates Inc. is a California corporation that allegedly provides business advice and legal and escrow services. Henley and Bioscience agreed that the loan money would be delivered to Goyette in escrow, and would not be released from escrow "except on the terms as required under the loan agreement and as instructed by" Henley.

On July 10, 2019, Henley wired $999,995 to the Goyette escrow account. The next day, Henley's authorized agent, Robert Kay, called Goyette from England to confirm that the money would not to be distributed without the express permission of Richard Butler, Henley's founder. Henley also alleges that Bioscience's president wrote to Goyette on Sept. 7, 2019 to say that the money would not be used without written authorization from Butler.

Henley alleges that Goyette disbursed the money to Bioscience and others without Butler's permission, including $5,000 that Goyette paid to itself. By September 2020, the money had not been returned to Henley.

Henley sued Bioscience and Goyette. Its claims against Goyette were for conversion, breach of contract and breach of fiduciary duty. Both defendants filed motions to dismiss.

The court refused to dismiss Henley's claim for conversion against Goyette. The escrowee argued that, at the time the money was delivered by Goyette, it was no longer the property of Henley, because it had committed to lend the money. The court noted that California does not require a plaintiff to show that it was the "absolute owner" of the money when it was converted; it is enough to allege that the plaintiff had an interest in the money and that it was misused or taken. Henley had alleged that it sent its own money to Goyette to hold in escrow, with specific instruction not to deliver it without approval, which the court held to be an adequate allegation of ownership. It relied in part on *Chase Inv. Servs. Corp. v. Law Offices of Jon Divens & Assocs., LLC*, 748 F. Supp. 2d 1145, 1179 (C.D. Cal. 2010), aff'd, 491 F. Appx. 793 (9th Cir. 2012), which found that the plaintiff retained ownership of property held in escrow.

Goyette also made the related argument that a "mere contractual right of payment, without more, does not entitle the obligee to the immediate possession necessary to establish a cause of action for conversion." It quoted from *In re Bailey*, 197 F. 3d 997, 1000 (9th Cir. 1999). The court rejected the argument, holding that Henley had alleged more than a mere contractual right of payment.

Goyette also argued that it had not committed a wrongful act, the second element of proof for conversion. It urged that Henley delivered the money as a loan to Bioscience, so delivery of the money to the borrower was not wrongful. The court rejected this argument by holding that Goyette's delivery of the money was not authorized, particularly as to the $5,000 that Goyette deducted as its fee. The court said that, "[t]hough the eventual transfer of funds to Bioscience would indeed be consistent with the parties' intentions, it was [Henley], not Goyette, that retained the right to choose when the transfer would occur (by way of the escrow instructions), if at all." Finally, the court held that Henley had adequately pled the full loan amount, $999,995, as being its damages against Goyette for the alleged conversion.

The court also refused to dismiss the breach of fiduciary duty claim against Goyette. The escrowee argued that no escrow existed, since the parties signed a loan agreement but no separate escrow instructions. The court disagreed, holding that Henley had adequately pled the existence of an escrow, and that Goyette had a fiduciary duty. The court relied chiefly on *Pasternak v. Boutris*, 99 Cal. App. 4th 907 (2002), which held that an escrow existed when lenders delivered loan money to an escrow agent, to be held back from the borrower until a condition or event had occurred. The court also noted that the definition of escrow in California Financial Code § 17003 does not require a written contract as a predicate for formation of an escrow. Section 17003 defines "escrow" as:

> … any transaction in which one person, for the purpose of effecting the sale, transfer, encumbering, or leasing of real or personal property to another person, delivers any written instrument, money, evidence of title to real or personal property, or other thing of value to a third person to be held by that third person until the happening of a specified event or the performance of a prescribed condition, when it is then to be delivered by that third person to a grantee, grantor, promisee, promisor, obligee, obligor, bailee, bailor, or any agent or employee of any of the latter.

Escrow Matters

Escrowee Required to Deliver Deposit to Seller Because Buyer Not Prepared to Close on Appointed Day

Callava v. Yon, ___ So.3d ___, 2022 WL 532759 (Fla.App. 3 Dist. 2022) (permanent citation not yet available).

A Florida court has ordered an escrow agent to pay the buyer's deposits to the seller because the buyer was not prepared to close on the established closing date, even though the seller had originally indicated it was fine with closing several days late.

In 2014, Fausto Callava contracted to buy commercial property in Florida from Patrick Yon. Title Company of America was appointed escrow agent. Callava deposited $100,000 into escrow before closing, which was to occur on June 23, 2014. The purchase contract contained these terms about delivery of the deposits:

> In the event, Buyer does not close as per contract, Seller will retain all deposits paid or agreed to be paid by Buyer. Seller and Buyer authorize Escrow Agent … to receive, deposit, and hold funds and other property in escrow and, subject to collection, disburse them in accordance with the terms of this Contract. In the event the sale is not closed due to any default or failure on the part of Buyer, Seller may either (1) retain all deposit(s) paid or agreed to be paid by Buyer as agreed upon liquidated damages, consideration for the execution of this Contract, and in full settlement of any claims, upon which this Contract will terminate or (2) seek specific performance.

Callava was not prepared to close on June 23. Callava and Title Company of America claim that "Yon was amenable to close on July 8." Thus, Title Company did not disburse the money to Yon.

However, it appears that the closing never occurred. Callava sued Yon about the contract. The trial court entered a final judgment ordering Title Company of America to release the $100,000 to Yon. Callava and Title Company appealed.

The appeals court affirmed. It gave this short analysis of the contract terms:

> It is undisputed that the closing date agreed to by the parties was June 23, 2014, Callava failed to close on that date and Title Company of America did not thereafter disburse the $100,000 deposit to Yon in accordance with the terms of the contract. We therefore find little difficulty in concluding there is competent substantial evidence that Callava and Title Company of America breached the terms of the contract.

Further, the court said that the fact that Yon had agreed to close on July 8, 2014 was "immaterial without a signed agreement where the written contract executed by both parties." The court noted that the contract said that "modifications of this Contract will not be binding unless in writing, signed and delivered by the party to be bound." The court noted the rule that a contract modification will not be enforced unless there is a writing signed by the party against whom the modification is asserted, citing *Bradley v. Sanchez*, 943 So. 2d 218, 222 (Fla. 3d DCA 2006). The court also relied on a number of decisions holding that an oral modification to a real estate purchase contract is unenforceable under the Statute of Frauds. It cited *DK Arena, Inc. v. EB Acquisitions I, LLC*, 112 So. 3d 85, 97 (Fla. 2013) (holding that under the Statute of Frauds, any modification to the contract was unenforceable unless memorialized in a written document signed by the parties); *Wharfside at Boca Pointe, Inc. v. Superior Bank*, 741 So. 2d 542, 545 (Fla. 4th DCA 1999) (finding that an attempted oral modification of an agreement by way of letter was insufficient to satisfy the requirements of the Statute of Frauds, the letter is merely an offer or confirmation of a prior oral offer, not an acceptance or confirmation of agreement signed by the party to be charged); and *Ocwen Loan Servicing, LLC v. Delvar*, 180 So. 3d 1190, 1194 (Fla. 4th DCA 2015) (concluding that under the Statute of Frauds, any modification to a contract is unenforceable unless memorialized in a written document signed by the parties).

The important escrow practice pointer from this decision is that the escrowee may obey an agreement that modifies the written escrow instructions or purchase contract only if both parties sign an amendment describing that change. This situation presented the common issue of the sliding closing date. An escrow officer could be tempted to rely on an oral understanding that the parties are pushing off the closing date while some issue is being resolved. This decision is a reminder that both parties must agree in writing to any such extension.

Conveyance News

Judgment Lien Attaches to Equity Greater Than Statutory Homestead Exemption Amount

In re McLauchlan, 502 P.3d 975 (Ariz. 2022).

The Arizona Supreme Court has held that a recorded judgment lien attaches to homestead property where the judgment debtor has equity in excess of the amount exempt under Arizona law, disapproving *Pacific Western Bank v. Castleton*, 246 Ariz. 108, 434 P.3d 1187.

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In 2015, Pacific Western Bank got a judgment in California against Todd McLauchlan. The judgment was domesticated and recorded in Arizona. In 2019, McLauchlan filed a Chapter 7 bankruptcy petition. In his schedules, McLauchlan listed a residence that he valued at $530,000 and a $376,677 note secured by a deed of trust on the house. McLauchlan claimed the Arizona statutory $150,000 homestead exemption in the residence.

Pacific Western filed a proof of claim for about $553,000 as secured by the recorded judgnment lien. McLauchlan received his Chapter 7 discharge. The Order of Discharge said that "a creditor with a lien may enforce a claim against debtors' property subject to that lien unless the lien was avoided or eliminated."

After the discharge, McLauchlan contracted to sell the house for $625,500. To close on the sale, McLauchlan and Pacific Western signed an "Escrow Agreement in Lieu of Foreclosure." McLauchlan's net proceeds of sale, after paying the deed of trust lender, were $206,852.58, or $56,852.58 more than his $150,000 homestead exemption.

Pacific Western filed a motion in bankruptcy court, asking the court to rule that its lien attached to the excess money. McLauchlan objected, arguing that under A.R.S. § 33-964(B), judgment liens do not attach to homestead property.

The bankruptcy court certified this question to the Arizona Supreme Court: Does a recorded judgment lien attach to homestead property where the judgment debtor has equity in excess of the amount exempt under Arizona law? The high court agreed to answer the question because no prior decision of that court had addressed the issue. The court answered the question with a yes.

Arizona's homestead exemption statute, A.R.S. § 33-1101 (2004), provides a $150,000 exemption from attachment, execution, and forced sale concerning a "person's interest in real property in one compact body upon which exists a dwelling house in which the person resides." The exemption "in identifiable cash proceeds continues for eighteen months after the date of the sale of the property or until the person establishes a new homestead with the proceeds." § 33-1101(C) (2004). A person or married couple may hold only one homestead exemption. § 33-1101(B)–(C) (2004).

The Supreme Court said that the clear purpose of the homestead exemption law is to assure that "individuals whose property is subject to foreclosure are not rendered homeless," quoting *Ferguson v. Roberts*, 64 Ariz. 357, 361, 170 P.2d 855 (1946). The court observed that, conversely, "[n]othing in the statute suggests an aim to shield proceeds in excess of the exemption from creditors, nor to confer any financial benefits upon debtors beyond the exemption."

The court acknowledged that, until the law was modified in 2007, a judgment lien did not attach to homestead property. The court cited to *Union Oil Co. of Ariz. v. Norton Morgan Com. Co.*, 23 Ariz. 236, 202 P. 1077 (1922); and *Evans v. Young*, 135 Ariz. 447, 661 P.2d 1148 (App. 1983). The former statute, A.R.S. § 33-964(A) (1999), said that a judgment became a lien on a debtor's real property "except real property exempt from execution." Section 33-964(B) (1999) stated, "A recorded judgment shall not become a lien upon any homestead property. Any person entitled to a homestead on real property as provided by law holds the homestead property free and clear of the judgment lien."

The legislature changed A.R.S. § 33-964(B) in 2007 to add this preamble: "Except as provided in § 33-1103… ." Also in 2007, the legislature amended A.R.S. § 33-1103 to say that a homestead is exempt from sale under a judgment or lien, except "[t]o the extent that a judgment or other lien may be satisfied from the equity of the debtor exceeding the homestead exemption." The court agreed with the lender that the statutory change had a plain meaning:

> …[T]he plain language of the statutes encompasses judgment liens that may be applied against property sale proceeds in excess of the homestead exemption. Adding the prefatory language to § 33-964(B) (2007) clearly effected a substantive change in the law, creating an exception that did not previously exist to an otherwise generally applicable law. Within that exception, § 33-1103(A)(4) (2007) speaks precisely to the application of a judgment lien to proceeds in excess of the homestead exemption.

McLauchlan countered that the purpose of the 2007 amendments was more limited, to add a new exception for child and spousal support liens, found in revised § 33-1103(A)(3). He said that view of the legislative history was accepted in a bankruptcy court opinion, *In re Rand*, 400 B.R. 749 (Bankr. D. Ariz. 2008). The *Rand* analysis had been adopted in *Pacific Western Bank v. Castleton*, 246 Ariz. 108, 434 P.3d 1187 (Ariz.App. 2018).

The Supreme Court replied that legislative history is not a substitute for clear legislative language, and the court does not consider such history unless the language is ambiguous. The court said the statutory language was not ambiguous. Also, *Castleton* was wrong because the legislature did not limit its "except as provided in" phrase to that part of Section 33-1103 that discusses child and spousal support liens.

The high court noted that *Castleton* had acknowledged that the law allows a judgment creditor to conduct a forced sale of a homestead when there is equity in excess of the exemption amount. The Supreme Court said that there is "no reason to treat proceeds in excess of the homestead exemption from a voluntary sale differently than proceeds from a forced sale." It said the law makes no such distinction, "stating categorically that 'a judgment or other lien may be satisfied from the equity of the debtor exceeding the homestead exemption.'" Neither § 33-964 nor § 33-1103 make any reference to the forced sale procedure of § 33-1105. Practically, the court said,

> McLauchlan's argument that the statutes shield his property from a judgment lien would effectively increase the amount of the homestead exemption to include surplus revenues from a voluntary sale above $150,000. As noted previously, … § 33-1101

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clearly limits the benefit to a single homestead exemption not exceeding $150,000 per person or married couple. Were we to allow McLauchlan to shield such proceeds against a judgment lien, it would create a windfall inconsistent with the statutory scheme.

McLauchlan's final argument was that 2021 amendments to § 33-964, which lay out a procedure for a judgment creditor to recover from proceeds in excess of the homestead exemption, "demonstrate that the earlier version of the statute did not allow such recovery." The court said that, to the contrary, the legislature may have intended to clarify the law or to overrule the *Castleton* decision on which McLauchlan relied. In any event, the court said, it "is the language of the statute which governs, and the unexpressed intent of the legislature has no application." It said that the 2021 amendments "are commendable for providing greater clarity going forward."

This decision will provide clarity for the future. It remains to be seen if the court's pronouncement is in line with the underwriting practices that title insurers have observed heretofore concerning attachment of judgment liens to homestead property.

Conveyance News

Texas Homeowners Cannot Use Constitutional HELOC Technicalities to Get Free House

Lopez v. JPMorgan Chase Bank, N.A., ___ F.Supp.3d ___, 2022 WL 220868 (S.D.Tex. 2022) (permanent citation not yet available).

A federal court has narrowly construed the Texas constitution's technical rules for the granting of a home equity loan on a homestead in order to prevent the borrowers from converting the homestead protection into a "free house."

Arnold and Hilda Lopez own a home in Houston. They got a home equity loan in 2016. The Texas Constitution requires that such a loan be closed at the office of the lender, its attorney, or the title company. Arnold Lopez signed the loan documents before a notary at the title company office. Hilda Lopez signed the documents before the same notary at her workplace.

The Lopezes made timely payments on the loan. On May 1, 2020, Loan Depot bought the loan. The Lopezes sent Loan Depot a notice to cure the Hilda Lopez signing problem. The lender said there were no violations and it did not offer to refinance the loan.

The Lopezes sued Loan Depot and the prior holders of the loan for violating the Texas Constitution, based on where Hilda Lopez signed the loan documents. They asked for a declaratory judgment that the mortgage is void and the return of all principal and interest they had paid on the loan.

United States District Judge Lynn N. Hughes did not mince words in her assessment of the action, in response to the lenders' summary judgment motion. She began by saying that the Lopezes "simply insist that they get the remedies for this harmless error that are in the Texas Constitution – a free house." Judge Hughes elaborated as follows:

> Article 50 of the Texas Constitution prevents the unauthorized sale of homes through brutally stringent requirements for lenders. Among them is a requirement to close the loan at a specific location. The remedy for violating this rule requires that the lender forfeit (1) their right in the homestead and (2) all principal and interest that has been paid by the buyer. Yes, that means a free house.
>
> The rights granted in the Texas Constitution propose to protect the homestead. The protection would be in these "technical errors." This "protection" largely raised the cost of lending on home equity, foregoing the homeowners access to employ the equity in their business or otherwise. It simply raises the cost of business and housing prices for future homeowners.
>
> The facts specific to this case demand a narrow holding that will not award Arnold and Hilda Lopez a free home for a technical error.

The lenders' first argument was that the Lopezes lacked standing to sue, since their dispute was based on "what ifs." The court noted that Article 50 does not grant a cause of action. However, Texas says that a party to a deed has standing to sue for breach of contract. The court held that the Lopez claim, of having to pay money on a loan secured by a bad lien, "is not typically recognized as standing." Further, the judge said, the Lopezes "want to prepare for defaulting on their payment by identifying defects in the event of foreclosure." She said that the Texas constitution "encourages homeowners to find defects in hopes that they can get a free home," leaving the lender "with zilch – plus some attorney fees." Nonetheless, she said the Lopezes had standing to sue.

The court turned to the Lopezes' claim under Article 50. It noted that the closing location requirement "was intended to prohibit a coercive closing of an equity loan at the home of the borrower," as was recited in *Fin. Comm'n of Texas v. Norwood*, 418 S.W.3d 566, 588 (Tex. 2013). The Lopezes emphasized that they sent a cure notice to the lender and it failed to fix the claimed problem within 60 days, and the lender also did not elect to refinance the loan. The court observed that the "catch-all measure in the Constitution offers debtors a refund for $1,000 and right to refinance to cure the defect." If the lender does not take that action, it forfeits all principal and interest.

The lenders said that "the constitutionally mandated corrective measures would not have actually cure the defect." The court agreed, saying:

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The catch-all provision would not have cured the defect because there is no defect to cure. The loan was not defective because Arnold Lopez signed at the constitutionally required location. Even though Hilda Lopez did not, she voluntarily consented to the lien by signing the deed of trust. The location she signed has no bearing on the validity of the loan because her husband signed at the required location. Her behavior may have triggered a "gotcha" for the lender but the loan remains without a defect because Arnold and Hilda Lopez own the home as a married couple. Arnold Lopez's signature was sufficient for the lien and he satisfied the lenders requirements. Her signature was unnecessary.

The lenders also asserted that the Lopezes had failed to prove that they sustained any actual damages as a result of the alleged signing defect, citing *Garfolo v. Ocwen Loan Servicing, LLC*, 497 S.W.3d 484, 497 (Tex. 2016). Judge Hughes agreed. She said that Arnold Lopez had no claim and no damages, because he signed the loan documents at the lawyer's office. She said that Hilda Lopez was not damaged by Loan Depot's decision not to offer to refinance the loan. The judge concluded with this statement:

> Arnold and Hilda Lopez did not sustain actual damages as a result of the uncured violation. The lender has never sought foreclosure. The lien is not void to the marital community. Hilda Lopez must have been able to show actual damages to invoke the drastic remedy of forfeiture. She does not. Her spouse has cured all of the defects in the validity of the debt against the marital property.

This decision is very worthy of note by lawyers charged with defending the validity of Texas homestead deeds of trust. Judge Hughes should get an award for her willingness to use common sense to cut to the heart of the issue in order to promote justice.