January 2023 • Volume 30, Issue 12

The Authoritative Source of Land Title Industry Litigation News Since 1992

THE TITLE INSURANCE LAW JOURNAL

American Land Title Association
Protect your property rights

Title Insurance

Exclusion 3(a) Negates Coverage For Rights in Off-Record Agreement Given to Insured Bank

First Nat'l Bank of Izard County v. Old Republic Nat'l Title Ins. Co., ___ S.W.3d ___, 2022 Ark. App. 440 (Ark.App. 1 Div. 2022) (permanent citation not yet available).

A title insurer had no duty to defend or indemnify the insured lender against a reversionary interest created in a sale agreement that was given to the lender but that was not recorded, because the reversion invoked Exclusion 3(a).

John Hardy and Helen and George Bartmess were members of a partnership and a limited liability company called B&H Resources LLC. The partnership and LLC owned several large real estate parcels in Arkansas. In 2009, the Bartmesses sold their interests in the partnership and B&H to Hardy under an LLC Membership Interest Purchase Agreement (which the court calls the LLC MIPA). One of the parcels sold to Hardy was a 377-acre tract in Izard County, Arkansas known as "Phillips Corner." It appears that the record owner of Phillips Corner was either the partnership or the Bartmesses individually. The LLC MIPA said that title to Phillips Corner would revert to the Bartmesses if Hardy did not comply with certain terms of the agreement.

Hardy got the money for the buy-out through three loans made by First National Bank of Izard County. Danny Moser was the bank president at the time, and served as loan officer for the Hardy loans. Moser received all of the documents about the LLC member sale, including the LLC MIPA. He later testified that he did not read the MIPA, however. He claimed he did not know that the Bartmesses had a reversion right in Phillips Corner.

The parties agreed to record a memorandum about the sale agreement. The memorandum did not recite the reversionary interest due to "confidentiality," the court said, but it did make the general statement that the agreement "affects real estate and rights in

Continued on Page 3

IN THIS ISSUE

alta.org/titlelaw

AMERICAN LAND TITLE ASSOCIATION

ABOUT US

The Title Insurance Law Journal, which is distributed electronicly each month by the American Land Title Association (ALTA), reports on cases addressing title insurance coverage, class actions and regulatory enforcement, escrow and closing duties, agent/underwriter disputes, conveyancing law, and RESPA and TILA compliance and violations.

This publication provides helpful information for title agents, approved attorneys, underwriters, claim administrators and attorneys who practice in title insurance defense work or conveyancing disputes.

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

PRICING

An annual subscription is $250 for ALTA members and $370 for non-members.

ALTA also publishes the *Title and Escrow Claims Guide* research book. To subscribe to the e-journal or purchase the book or annual update, please go to **alta.org/titlelaw**. For more information about the title insurance industry or to become a member, go to **alta.org**.

CONTACT US

1800 M Street NW,
Suite 300 South
Washington, DC 20036-5104
p. 202.296.3671
f. 202.223.5843
w. alta.org
e. service@alta.org

Continued From Page 1

real estate." The memorandum attached legal descriptions for several parcels owned by B&H, including Phillips Corner.

The LLC member sale and the loans closed at the bank offices. A bank employee sent the Izard County Clerk the deed from the Bartmesses to Hardy for Phillips Corner, the lender's three mortgages and the memorandum, with instructions that they were to be recorded in the order noted in pencil on the instruments. The clerk appears not to have recorded the instruments in the specified order, because the memorandum was recorded four minutes before the mortgages on Phillips Corner. However, the bank employee did not review the original documents returned to her or fix the problem.

Old Republic National Title Insurance Company issued three loan policies to the bank. The court said that the policies were issued "with no priority interest, notation, or exclusion relating to the Memorandum filed of record on February 23, 2009."

Hardy defaulted on the loans. The bank filed a judicial foreclosure sale in federal court, naming as defendants Hardy, B&H and Helen Bartmess. George Bartmess died before the foreclosure action was filed. Helen filed an answer claiming that her reversionary interest had priority over the mortgages on Phillips Corner. She alleged that the bank had actual knowledge and constructive notice of her interest.

The bank tendered its defense of the Bartmess claim to Old Republic. The insurer declined to defend the bank, based on Exclusion 3(a). The bank then settled with Helen, stipulating that her interest had priority over the mortgages "by virtue of the Memorandum and LLC MIPA." The bank released its mortgages on the Phillips Corner property. The bank still held a mortgage on another large tract of land.

The bank sued Old Republic for the cost of defense and indemnity. Old Republic counterclaimed, seeking a declaration that its denial was proper under Exclusion 3(a). The court ruled in favor of the title insurer after a hearing on the competing summary judgment motions filed by both parties. The court held that the bank had created, suffered, assumed or agreed to take its mortgages subject to the Bartmess reversionary interest because it possessed the LLC MIPA before the mortgages were executed, and it controlled the recording process. In this decision, the court of appeals affirmed that ruling.

This Arkansas appellate court has issued only one prior decision construing Exclusion 3(a), *Bourland v. Title Ins. Co. of Minn.*, 4 Ark. App. 68, 627 S.W.2d 567 (1982). *Bourland* held that the word "suffered" is synonymous with "permit" and implies a power in the insured to prohibit the act giving rise to the defect. In that case, the court held that the insureds had not permitted the defect in their title as a matter of law due to their knowledge that their seller had issued a prior deed to her brother that was recorded. *Bourland* said that knowledge of the deed did not bar coverage as a matter of law because the insured "had nothing to do with the execution or recording of the deed and had no power to prohibit it." Concerning the related argument that the insureds had created the title defect by their willful misconduct in conspiring with their seller to defraud the brother of title, *Bourland* said that there was a question of fact precluding summary judgment.

First, the bank sought to convert *Bourland* to a formula under which the insurer would have to prove that three elements were all true:

> (1) the insured party has actual knowledge of the defect; (2) the knowledge is not possessed by the insurer; and (3) the actual knowledge on the part of the insured is willfully withheld.

The court disagreed. It admitted that, in *Bourland*, the court had held that the exclusion did not apply as a matter of law because the insured had nothing to do with recording the deed to the brother, and could not have prohibited its recording. The court said that "[s]uch is not the situation in this case." The bank had been involved in the sale to Hardy for months before closing. It had been informed of the agreement's terms, including through a letter faxed to the bank. A copy of the LLC MIPA had been delivered to the bank before closing. The loan officer merely claimed that he had not bothered to read it. Perhaps most importantly, a bank officer had sent the documents directly to the clerk to be recorded, and thus the bank had control over the recording order. The court held that the mortgages lost priority over the reversionary interest because the memorandum was recorded before the mortgages. The court concluded:

> Thus, the facts herein are unlike the facts in *Bourland* in that, here, the Bank had within it the power to prohibit the Memorandum from having priority over

Continued on Page 4

Continued From Page 3

its mortgages.

The appeals court also rejected the bank's attempt to limit Exclusion 3(a) to willful misconduct. It said:

> We are not persuaded that our decision in *Bourland* requires some willful intent on the part of the insured. In addition, as will be discussed below, this is not a situation where the circuit court held that the Bank's knowledge alone supported Old Republic's denial of coverage; therefore, willful intent on the part of the Bank was not required for the paragraph 3(a) exclusion to apply.
>
> Accordingly, we find no error in the circuit court's finding that the undisputed facts establish that the Bank could have prohibited and prevented the claim from arising; therefore, pursuant to Arkansas law, the defect in title was "created, suffered, assumed, or agreed to" by the Bank, and coverage was properly denied under paragraph 3(a) of the Policies.

The appeals court also held squarely that the bank was misguided in seeking to construe the exclusion based on which party had actual knowledge or constructive notice and to what degree. For example, the bank argued that it had no actual knowledge of the reversionary right because bank president Danny Moser did not read the LLC MIPA when it was given to him. The court addressed the knowledge issue this way:

> The Bank's first, second, and fourth arguments all center on the issue of knowledge. In fact, the Bank expended a substantial portion of its brief discussing the issue of knowledge; more specifically, who did or did not have knowledge—either actual or constructive—of the contents of the Memorandum, and what effect such knowledge, or lack thereof, should have had on the circuit court's ruling. We are not persuaded that these arguments are germane to the issue presented on appeal.
>
> The Policies contained two separate exclusions in paragraph 3: 3(a) and 3(b). As previously discussed, paragraph 3(a) excludes "[d]efects, liens, encumbrances, adverse claims" that were "created, suffered, assumed, or agreed to" by the insured. Paragraph 3(b) excludes "[d]efects, liens, encumbrances, adverse claims ... not Known to the Company, not recorded in the Public Records at Date of Policy but known to the Insured Claimant." Giving this contractual language the meaning that the parties intended, we hold that knowledge, either actual or constructive, is immaterial to the paragraph 3(a) exclusion; thus, it is unnecessary for this court to discuss the merits of such.

The court also rejected the bank's related argument that the trial court had imposed the exclusion based on a finding that the bank had inquiry notice of the terms of the LLC MIPA. The bank argued that, to the contrary, it was entitled to rely on Old Republic's "search, opinion, and guarantee" in determining which matters affected title. The court said this argument misconstrued what the trial court had ruled:

> … [T]he circuit court's statement that the facts warranted the Bank's further inquiry into the terms of the Memorandum was not the court imposing a duty on the Bank to identify potential defects in title; rather, the court was merely establishing that the Bank could have prevented the claim from arising under the established precedent in *Bourland*. For this reason, we find no merit to this argument.

Finally, the appeals court upheld the trial court ruling that Old Republic had no duty to defend the bank against the Bartmesses' affirmative defense. Old Republic asserted the rule that, where no policy coverage exists, there is no duty to defend, citing the sole Arkansas Supreme Court decision construing Exclusion 3(a), *Mattson v. St. Paul Title Co. of the South*, 277 Ark. 290, 641 S.W.2d 16 (1982). The appeals court acknowledged that *Mattson* had held that "the paragraph 3(a) exclusion precludes an insurance company from paying for losses an insured inflicts on itself." Because it had already ruled that Exclusion 3(a) barred coverage, Old Republic also had no duty to defend.

This is an excellent and straightforward decision. It should be useful, because the ruling is based on a set of facts that is quite common. The court's conclusion that knowledge is irrelevant in deciding if the insured created, suffered, assumed or agreed to a title issue is particularly helpful, as a rebuttal to those who argue that knowledge is implicit in the terms "created," "suffered" and "agreed to." This court got it right by observing that the defined term Known appears in and relates to Exclusion 3(b), not Exclusion 3(a).

Old Republic was ably represented by Monte Estes of Dover Dixon Horne PLLC, Little Rock.

Title Insurance

Title Agent Wrongly Joined to Defeat Federal Diversity Jurisdiction

Naber v. First American Title Ins. Agency, Inc., ___ F.Supp.3d ___, 2022 WL 16832644 (W.D.N.Y. 2022) (permanent citation not yet available).

A New York court has held that an insured improperly added the title agent and abstractor as defendants in a policy coverage action, with the sole purpose of defeating federal diversity jurisdiction, and has refused to remand the case to state court.

Aaron and Marci Naber

Continued on Page 5

Continued From Page 4

sued First American Title for breach of contract in regard to their title insurance policy. They sued in Steuben County Supreme (trial) court. The Nabers also named First American Title Insurance Agency, Inc. in the action, although all claims were based on the policy.

First American removed the case to the Western District of New York based on diversity jurisdiction, pursuant to 28 U.S.C. § 1332(a)(1). The Nabers are New York residents. First American is domiciled in Nebraska. First American Title Insurance Agency is domiciled in New York.

After FATIC removed the case to federal court, the Nabers filed an amended complaint adding Abar Abstract Corporation as a party. Abar Abstract Corporation is also a New York company. However, the Nabers did not modify their substantive allegations, which made no mention of Abar.

After amending the complaint, the Nabers moved to remand. The parties agreed to have the motion decided by a federal judge.

First American argued first that there was complete diversity when it removed the case to federal court, The court disagreed, explaining that:

> It appears that FATIC misunderstands the relationship between 28 U.S.C. § 1332 and 28 U.S.C. § 1441(b). Complete diversity between all plaintiffs and all defendants is required for federal jurisdiction under 28 U.S.C. § 1332. *Lincoln Property Co. v. Roche*, 546 U.S. 81, 89 (2005). Even where complete diversity exists, however, removal under § 1441(b) is not appropriate where there is a home-state defendant—that is, a defendant who resides in the forum state. … There is an exception to the home-state rule, in the text of § 1441(b) itself, for when the home-state defendant has not yet been served. In other words, where there is complete diversity and an unserved home-state defendant, the case can be removed. But that is an exception to the § 1441(b) home-state rule, not to the requirement of complete diversity for jurisdiction under § 1332. While there is an exception for unserved, home-state defendants that might allow for removal under § 1441(b), there is no parallel exception for unserved, home-state defendants that allows federal diversity jurisdiction under 28 U.S.C. § 1332.

Thus, the court said that, because First American Agency is domiciled in New York, "there was never complete diversity to begin with." The court also noted that First American was alluding to the practice of "snap removal," which is the removal of a case that names a home-state defendant before that defendant is served. The court said that, when there is no complete diversity, "the fact that the home-state defendant has yet to be served is irrelevant, which would render removal improper," citing *Galiano Constr. Custom Builder, LLC v. Brandon Sample*, No. 20-CV-106 (GWC), 2020 WL 8093522, at *2 (D. Vt. Oct. 22, 2020) and other decisions.

However, the court did agree with First American that the Nabers had added First American Agency and Abar solely to defeat federal diversity jurisdiction, and that the proper course was to dismiss them as defendants and deny the motion to remand to state court. The court began by citing these principles:

> "[A] plaintiff may not defeat a federal court's diversity jurisdiction and a defendant's right of removal by merely joining as defendants parties with no real connection with the controversy." *Pampillonia v. RJR Nabisco, Inc.*, 138 F.3d 459, 460–61 (2d Cir. 1998). "Fraudulent joinder is a legal term of art [used] to refer to the joinder of unnecessary or nominal parties in order to defeat federal jurisdiction." *Kuperstein v. Hoffman–Laroche, Inc.*, 457 F. Supp. 2d 467, 470 (S.D.N.Y. 2006) (citation omitted).
>
> In order to show that naming a non-diverse defendant is a "fraudulent joinder" effected to defeat diversity, the defendant must demonstrate, by clear and convincing evidence, either that there has been outright fraud committed in the plaintiff's pleadings, or that there is no possibility, based on the pleadings, that a plaintiff can state a cause of action against the non-diverse defendant in state court. *Pampillonia*, 138 F.3d at 461.
>
> * * * *
>
> "[W]here a complaint names as a defendant a non-diverse party against whom no claim is asserted nor from whom no relief is requested, the non-diverse party has been fraudulently joined and can be disregarded as misjoined for purposes of establishing diversity jurisdiction." *County of Niagara v. Liberty Mut. Ins. Co.*, No. 14-CV-00737A(F), 2016 WL 2997903, at *4 (W.D.N.Y. May 24, 2016) (citing *Whitaker v. Am. Telecasting, Inc.,* 261 F.3d 196, 207 (2d Cir. 2001)), *report and recommendation adopted sub nom. Niagara v. Netherlands Ins. Co.*, No. 14-CV-737A, 2016 WL 3280367 (W.D.N.Y. June 15, 2016).

The court applied that test to the Naber complaint. After identifying First American Agency and Abar Abstract, the complaint said nothing about them, and made no claims against them. Neither company was a party to the title insurance policy, which was the sole contract at issue in the lawsuit. The only information about First American Agency was in an affidavit, in which the Nabers' lawyer asserted "on information and belief" that First American Agency is a subsidiary of First American Title. Similarly, Abar's name appeared on the policy only in the "issued by" block, and the Nabers' attorney asserted in oral argument only that Abar "sold" the policy. The court thus concluded that joinder of both companies was not proper, and it ordered the dismissal of those defendants.

This is a very good decision on a recurring issue—the joinder of a local title agent to destroy federal diversity jurisdiction.

First American was ably represented by Marc William Brown of Goldberg Segalla LLP, Buffalo.

Title Insurance

Claims Counsel Communication Privileged in Insured's Quiet Title Action

240 GA, LLC v. Greenwich Harbor View Ass'n, Inc., 2022 WL 17102225 (Conn.Super.) (unpublished).

When a title claim led to a quiet title action, the communication between insured and title insurance claims counsel was privileged work product prepared in anticipation of litigation.

240 GA LLC is the owner of a parcel known as Unit 73A, located in Greenwich, Conn. 240 GA brought a quiet title action against the Greenwich Harbor View Association, Inc. concerning "limitations on the use" of Unit 73A.

240 GA had submitted a title insurance claim about two years before the quiet title action was filed. The association sought communication between 240 GA, its transactional attorneys and the title insurance claims counsel. 240 GA claimed that the communication was protected by the attorney-client privilege and the work product doctrine. This decision was issued on the association's motion to compel discovery of the communication.

The court rejected the association's first contention, that the communication occurred too long before the filing of the action to be considered to have been in anticipation of litigation. It said:

> There is no requirement that litigation be commenced within a fixed period of time for a communication to be deemed "in anticipation of" litigation (*Practice Book* § 10-3). To the extent that the court's understanding is that the plaintiff's strategy … was to get its title insurance company involved, then a necessary threshold for litigation would be to assemble the information and analysis needed for a submission to that carrier. … There may have been a long lead-up to litigation, but the court cannot credit the defendant's characterization that "there was not even any anticipated litigation."

The court also dismissed the association's assertion that the work product doctrine should apply only to litigators:

> The defendant also draws a distinction between real estate lawyers and trial lawyers. As repeatedly stated by the plaintiff, there is no identified or known basis for that type of distinction with respect to claims of privilege. (Is this intended to be analogous to the distinction between solicitors and barristers (assuming that such a distinction in title would have a bearing on privilege issues)?) Does that mean that a sole practitioner (or small office generalist) can assert a privilege that is not available to "specialists" such as real estate attorneys and "litigators" who may work in a coordinated manner?
>
> Indeed, the work-product privilege not only is not limited to trial lawyers as distinct from real estate lawyers; it does not require status as a lawyer. *Practice Book* § 13-3(a) defines/describes the privilege in terms of parties and representatives ("prepared in anticipation of litigation or for trial by or for another party or by or for that other party's representative"). *Practice Book* § 13-1(a)(3), in turn, defines the term "representative" as including an "agent, attorney, consultant, indemnitor, insurer and surety" such that there is no plausible basis to limit the work product privilege to trial counsel.

The court said that the title insurance claims counsel also fell in the category of representatives of 240 GA who were communicating in anticipation of litigation:

> This also addresses the defendant's identification of two individuals who were employed by the title insurance company ("The remaining three emails (Nos. 131, 133 & 146) were written by employees of Fidelity Title (Mr. Huben and Ms. Vasey), which is a third party not entitled to invoke the Work Product Doctrine") – the title insurance company can be and is claimed to have been acting in furtherance of preparation for litigation, and employees necessarily would be encompassed by the privilege. That is in addition to the proffer of the plaintiff that those individuals were attorneys, working for the title insurance company. On a number of levels, then, the defendant is applying principles relating to work product in an unduly-narrow manner.

In addressing the title insurance claims counsel communication, the court applied a prior Connecticut decision, *Hill v. Northland Casualty Co.*, Docket No. CV156056488S, 2015 WL 6405764, 2015 Conn. Super. LEXIS 2482, (Super. Sep. 25, 2015). In *Hill*, the court held that documents prepared by an insurance company attorney as part of the claim investigation were not privileged. *Hill* listed a set of factors that the court should consider:

> … (1) whether the investigation is of a third-party claim, the very nature of which is anticipating litigation, or a first-party claim; (2) that insurer-authored documents are more likely than attorney-authored documents to have been prepared in the ordinary course of business; (3) that the work product doctrine most strongly protects the mental processes of the attorney, providing a privileged area in which to analyze and prepare a client's case as opposed to documents which consist of factual materials and analyses of facts; (4) that actions taken by an insurance company immediately after being notified of a potential claim are almost always part of its ordinary business of claim investigation; and (5) …

Continued on Page 5

Continued From Page 6

that blanket assertions of work product as to entire files, rather than specific documents are never sufficient to prevent discovery, since the party opposing discovery must establish that each document is work product.

The court said that most of the *Hill* factors favored privilege, when applied to this case. Further, the court said this:

> This court believes that a key factor not identified or discussed – because it probably represents a small percentage of insurance-related litigation – is that this case involves title insurance. Most litigation cases involving insurance would seem to involve damage to property or personal injury – an event causing or alleged to have caused an injury. An insurance company involvement in such claims – and the likely reason for the observation above that "that actions taken by an insurance company immediately after being notified of a potential claim are almost always part of its ordinary business of claim investigation" – is largely fact-gathering at the outset. Even a determination of "who" is responsible for a tort loss, while requiring application of some level of legal analysis, is largely fact-driven. In Hill, the court discussed and relied upon *QBE Ins. Corp. v. Interstate Fire & Safety Equipment Co.*, Docket No. 3:07cv1883 (SRU), 2011 WL 692982, 2011 U.S. Dist. LEXIS 16406 (D. Conn. Feb. 18, 2011), a fire casualty subrogation case, where the notes of an adjuster (first party claim) were held to be outside the privilege. The adjuster was described as involved in "investigating whether it had subrogation rights to enforce." The activities started within about a week of the incident itself, after an expert (cause-and-origin expert) had determined the likelihood of third-party responsibility.
>
> While some title insurance matters may have a fact-intensive quality (e.g., quiet title involving adverse possession or prescriptive easement), many – and apparently this case – involve analysis of legal instruments with limited factual investigation needed. The complement to the limited factual content is that the evaluation of legal prospects and strategizing become thought-process-intensive, the most protected aspect of work product.
>
> Despite the defendant's contentions, it appears that all of the individuals identified as preparers/senders or recipients of the documents in question are/were lawyers.

The court also distinguished two other Connecticut decisions that had allowed discovery of insurance claim investigation documents, involving other types of insurance policies, *Jacobs v. Dickey*, N.H. Super. LV94-0359518S, 1998 Conn. Super. LEXIS 396, and *Page v. Dimaggio Plumbing & Heating*, Danbury Super. CV98-0334003S, 2000 Conn. Super. LEXIS 3187. The court noted that the ruling in *Jacobs* was based mainly on the fact that the insurance company representative was not an attorney, and the claim investigation was an event log reflecting no legal analysis. In *Page*, the claim investigation concerned facts about an oil spill, and no insurance company lawyer was involved in collecting those facts.

Finally, the court held that 240 GA had not waived the privilege by disclosing redacted versions of some of the claim documents, when the redactions were for the analysis made by the Fidelity National claims counsel. The court said this:

> The redacted version of Exhibit 1 explicitly is characterized by the plaintiff as not work product – it is characterized as a document from which all work product has been redacted. To the extent that title insurance companies and real estate attorneys routinely deal with chains of title and related presentations, this would be in the nature of not-litigation-oriented work routinely done. It is only the commentary-type notes that are claimed to be work product, claimed to justify redaction.

This comment is helpful because the court applied the privilege to the lawyer's analysis of the chain of title, while acknowledging that there is no privilege in the fact investigation documents such as title searches and documents in the chain of title.

This is one of only a few decisions that have analyzed the assertion of privilege in communications from a title insurance claims counsel to the insured, and perhaps the only decision to address such missives sent before the suit was filed. The court correctly perceived that it is often the claims counsel who first analyzes the insured's legal rights in relation to the adverse party, in order to determine if the claim should be resolved by suing to quiet title. Allowing the defendant to read that analysis would indeed give it an unfair tactical advantage in the lawsuit, which the work product doctrine is designed to prevent.

Title Insurance

Title Insurer Claims No Interest in Property by Conducting a Closing

Lynch v. DeMotte State Bank, ___ F.Supp.3d ___, 2022 WL 4300455 (N.D.Ind. 2022) (permanent citation not yet available).

A property owner's lawsuit claims against a title insurer have been dismissed because, contrary to the owner's allegation that the insurer claimed an interest in the property, it had merely collected a loan payoff statement for a refinance closing.

Kathy Lynch owned a house in Kouts, Ind., subject to a mortgage. She claims to have made substantial payments on the mortgage loan.

It appears that Lynch tried to sell the house in 2016. Chicago Title Company LLC requested a payoff statement for the loan. Loan servicer DeMotte State Bank demanded payment of the net proceeds of sale, but by Lynch's calculations the payoff amount should have been less than $25,000. The sale did not close. The lender later foreclosed, and the state court issued an eviction order to Lynch.

Lynch then filed this *pro se* action against the loan servicer, and also naming Chicago Title as a defendant. Lynch made two allegations concerning Chicago Title. She alleged that it "claims an interest adverse to the right, title, and interests of Plaintiff in the Subject Property." She also alleged that DeMotte issued a payoff statement "to Chicago Title."

Chicago Title responded by filing two documents, a disclaimer of interest and a motion to dismiss. In the disclaimer, Chicago Title stated:

> Defendant Chicago Title is a title company, not a bank, mortgage company, or loan servicer, and neither owns nor claims any title, lien, or interest in or to the Subject Property. Chicago Title hereby disclaims any and all title, lien, or interest in the real estate that is the subject of this lawsuit.

Chicago Title also attached to its motion to dismiss various documents filed in the foreclosure action, showing that Chicago Title was not named in that lawsuit. The company also attached three Chapter 13 bankruptcy petitions that Lynch had filed over a span of five years. Lynch had never listed any claim against Chicago Title as an asset of her estate, or named the company as a creditor.

The court noted that Lynch's only explanation about her claim against Chicago Title, first asserted in her response brief, was to assert that Chicago Title and DeMotte acted jointly and in concert "to conceal the funds" she had paid toward the loan principal. The court said this allegation was not found in the second amended complaint, and the brief "identifies no facts in support of this new, bald allegation." Also, the court held that Lynch had failed the heightened pleading standard of Federal Rule of Civil Procedure 9(b), which requires the plaintiff to "state with particularity the circumstances constituting fraud or mistake." Therefore, the court dismissed Chicago Title and refused to allow Lynch to amend her complaint further.

Chicago Title's filing of the disclaimer was a very effective technique for highlighting the error in Lynch's claim against the company. Its filing of the bankruptcy petitions, showing that Lynch had never identified a claim against Chicago Title as an asset of her estate, was also very wise. It is reminiscent of *Agha-Khan v. Mortgage Electronic Registration Systems Inc.*, 2018 WL 3745814 (D.Nev. 2018) (unpublished), in which the court held that a plaintiff was estopped from suing a title insurer and title agent for title-related claims because she had not disclosed those claims in her bankruptcy schedules. *Agha-Khan* was reported in the October, 2018 issue.

Chicago Title was represented by David J. Theising of Harrison & Moberly LLP, Indianapolis.

Title Insurance

Loan Policy Successor Rights Tested

U.S. Bank N.A., as Trustee v. Fidelity Nat'l Title Group, Inc., ___ F.Supp.3d ___, 2022 WL 17095223 (D.Nev. 2022) (permanent citation not yet available).

A Nevada court has held that a successor deed of trust holder may sue for policy breach after a prior insured submitted a claim notice. Also, the court held that a claim under the Nevada Deceptive Trade Practices Act may be assigned and asserted by the later holder of the loan.

RMS & Associates made a loan secured by a deed of trust on a condominium unit in Las Vegas in 2007. RMS got a loan policy from Lawyers Title.

The owner stopped paying condominium assessments in 2011. The association held a non-judicial foreclosure sale in 2012, at which the high bidder was SFR Investments.

The loan was assigned several times. Christiana Trust held the loan in 2015. It made a claim on the policy that year, based on the 2012 foreclosure sale. Fidelity National Title, as successor to Lawyers Title, denied the claim. Christiana Trust sued to quiet title in 2016 and asked Fidelity to defend against SFR's ownership claim. Fidelity first accepted the tender, and then withdrew because of tardy notice.

While the quiet title action was pending, Christiana Trust assigned "the deed of trust" to U.S. Bank, as "legal title trustee for the Truman 2016 SC6 Title Trust." The court refers to an "unbroken chain of assignments" of the deed of trust, but does not refer to assignments of the loan.

U.S. Bank sued Fidelity under the policy, for bad faith and for an alleged violation of the Nevada Deceptive Trade Practices Act. It did not submit a claim notice to Fidelity, or establish ownership of the loan, before bringing suit.

Fidelity moved to dismiss the action for two reasons. The court phrased its argument concerning the policy as being that U.S. Bank had no standing to sue under the policy because, "at the time of the underlying litigation, Christiana Trust was the beneficiary of the deed of trust and the entity that submitted the claim." Fidelity relied on *Cusano v. Klein*, 264 F.3d 936 (9th Cir. 2001), for the proposition that the assignment of an interest in real estate does not necessarily assign the right to claims about the property. The court sidestepped the argument, saying:

> The policy names the insured as "RMS & Associates, its successors and/or assigns as their respective interests appear." … Plaintiff alleges an unbroken chain of assignments to itself. … The plain language of the policy thus confirms that plaintiff is the "insured" under the policy and is eligible to bring these claims.

The assignability

Continued on Page 9

Continued From Page 8

> of the policy would be meaningless if an assignment did not also carry with it the ability to enforce the policy's provisions as a matter of law. If plaintiff were prohibited from bringing these claims, there would be no party left to assert them, as the assignment to plaintiff means there is no longer another "insured" under the policy. … By including successors in the definition of "insured," the policy specifically contemplates that a successor, necessarily, gains the rights of the insured after the assignment.

However, the court did not accurately interpret the policy definition of insured. That definition states that each successor owner *of the Indebtedness* becomes an insured. The claimant does not establish that it is an insured by presenting a chain of assignments of the deed of trust, but rather by proving the assignment of the note. When a prior holder of the note has submitted a claim notice, the title insurer is entitled to receive proof that a later claimant is the new holder of the note. The court failed to understand the point, concluding as follows:

> Further, there is nothing in the policy to suggest that defendant's position regarding resubmission of the claim has any merit. Defendant indicates that several policy conditions, including conditions 3, 5(a), 7, 8, and 1(f) obligate plaintiff to have resubmitted a claim when it became the "insured" under the policy. … However, each of these conditions require only that the "insured" have submitted a claim; they do not specify which "insured."

Thus, the court held that the policy claims survived the motion to dismiss.

Fidelity was not merely picking nits in asserting that the bank had to establish its status as the insured, and that a chain of recorded assignments of the deed of trust was not sufficient proof. A better indicator would have been that U.S. Bank had been substituted as the plaintiff in the quiet title action. The court did not say that such a substitution had taken place.

Further, title veterans will remember that the RTC adopted the cute practice of assigning loans but purporting to retain the right to make policy claims. Title insurers had to sue to prove that the RTC had no standing to assert policy claims after assigning the loans. *Stewart Title Guar. Co. v. National Enterprises, Inc.*, 133 F.3d 929 (Table), 1997 WL 800294 (9th Cir. Cal.) (unpublished). In addition, U.S. Bank was not the holder of either the deed of trust or the loan in its own right. Rather, it was "legal title trustee for the Truman 2016 SC6 Title Trust." That name alone raises the suspicion that ownership of the loan and "title" to the deed of trust might have been fractured. The claimant is supposed to have the burden of proof in establishing that it is the insured, and the insurer is entitled to probe what rights the Truman Title Trust holds.

The court also refused to dismiss U.S. Bank's claim under the Deceptive Trade Practices Act. Fidelity argued that a claim under that law is not assignable. Nevada follows the rule that tort claims sounding in fraud are not assignable. *Gruber v. Baker,* 23 P. 858, 862–63 (Nev. 1890). A claim under the DTPA is a fraud claim. Therefore, Fidelity said, the claim was not assignable.

The court distinguished *Gruber* because Nevada has said that the statutory fraud claim under the NDTPA is "separate from" common law fraud. *Betsinger v. D.R. Horton, Inc.*, 232 P.3d 433, 435–36 (Nev. 2010), and the law is liberally construed. *R.J. Reynolds Co. v. Eighth Judicial District Court,* 514 P.3d 425, 431 (Nev. 2022). The court said that U.S. Bank may not ultimately succeed on the claim, but it was allowed to proceed at this stage.

This ruling on the NDTPA claim is subtly different from the holding in *Wells Fargo Bank N.A. v. Fidelity Nat'l Title Group, Inc.*, ___ F.Supp.3d ___, 2022 WL 16527722 (D.Nev. 2022) (permanent citation not yet available), reported in the December, 2022 issue. In Wells Fargo, the court dismissed the NDTPA claim because the lender had not even alleged that the original lender had assigned the claim along with the loan. The *Wells Fargo* court said that, while such a claim may be assigned, there must actually be an assignment. The assignment of the deed of trust alone did not implicitly assign the statutory tort claim also.

Agent Focus

Tax Deed Voided Because Litigation Guarantee Listed Wrong Address

Wells Fargo Bank, N.A. v. Zinvest, LLC, 2022 MT 224, ___ P.3d ___ (2022) (permanent citation not yet available).

The Montana Supreme Court has voided a tax deed because notice to the lender was sent to the wrong address, as listed in a litigation guarantee.

In 2015, the Missoula County treasurer conducted a tax sale of two parcels, apparently owned by the same party. Zinvest LLC bought the taxes. In 2016, Zinvest had the treasurer issue tax sale certificates. Tax deeds would be issued if the taxes were not redeemed.

Zinvest got two litigation guarantees from Stewart Title. Schedule B of each litigation guarantee listed Wells Fargo Bank, N.A. as a party to receive a notice of redemption, because it held a deed of trust that encumbered both parcels. Schedule C said it recited "[t]he return addresses for mailing after recording, if any, as shown on each and every document referred to in Part II of Schedule B… ." Schedule C listed the mailing address for Wells Fargo as 3601 Minnesota Dr, Suite 200, Bloomington, MN 55435. This address was derived from the "return to" box on the deed of trust.

Zinvest sent notices to Wells Fargo at the Bloomington address. The notices were returned, marked "not deliverable as addressed –

Continued on Page 10

unable to forward." Zinvest also published notices in the *Missoulian*. Zinvest then prepared a proof of notice attesting that it had mailed notices of the issuance of tax deeds to the "owners, current occupant and parties" pursuant to § 15-18-212, MCA, via certified mail, return receipt requested. Based on the proof of notice, the Missoula County treasurer executed tax deeds conveying the parcels to Zinvest in August of 2018.

In 2020, Wells Fargo sued Zinvest, asking that the tax deeds be declared void. It said that Zinvest sent the redemption notice to the wrong address. In the body of the deed of trust, the lender's address was listed as being a post office box in Des Moines, Iowa. The deed of trust specifically said that "tax statements" were to be sent to the Des Moines post office box. Also, the return to address in Bloomington was for a sister company, Wells Fargo Home Mortgage, which was not the lender in the deed of trust.

Section 15-18-212 of the Montana Code Annotated requires that redemption notices be sent to:

> … each party … listed on a litigation guarantee, provided that the guarantee … lists the identities and addresses of the parties of record that have an interest … in the property designed to disclose all parties of record that would otherwise be necessary to name in a quiet title action.

The statute also says that the notice must be sent to "the address disclosed by the records in the office of the county clerk and recorder or in the litigation guarantee." Zinvest's simple argument at the trial court level was that it complied with the law by sending the notice to the address recited in the litigation guarantees. Wells Fargo's equally simple argument was that Zinvest did not comply with the law because it did not use the address listed in the recorded deed of trust.

The trial court ruled in Zinvest's favor. On appeal, the Montana Supreme Court reversed, and voided the tax deeds.

The high court accepted the bank's argument that Zinvest did not give satisfactory notice because the litigation guarantees did not list the address for Wells Fargo that the law requires. It said:

> A party may rely on the information disclosed in a litigation guarantee provided the guarantee lists the addresses for the parties of record. Section 15-18-212(4)(a)(iii), MCA. The Litigation Guarantees here, however, provided the incorrect address for Wells Fargo Bank, N.A. … Wells Fargo's Deed of Trust clearly provided a known and identifiable address to send the notices that tax deeds may issue, yet the Litigation Guarantees did not list this address. … By providing the incorrect address, the Litigation Guarantees did not satisfy the statutory requirements of § 15-18-212, MCA, and Zinvest improperly relied on them for purposes of providing notice to Wells Fargo. … Zinvest's failure to mail Wells Fargo the notices at the Iowa address listed for it in the recorded Deed of Trust violated § 15-18-212, MCA. Accordingly, Zinvest's failure to give the statutorily required notice that tax deeds may issue renders the tax deeds void.

The court also rejected Zinvest's argument, raised on appeal, that notice was adequate because of publication. In *Showell v. Brosten*, 2008 MT 261, 345 Mont. 108, 189 P.3d 1210, the court had held that constructive notice by publication is ineffective if the statutory requirements for personal service are not met, rendering a tax deed void.

The court also rebuffed Zinvest's other argument on appeal, that Wells Fargo had created "uncertainty" by listing two different addresses in the deed of trust. The court said the latter argument overlooked the "plain language" in the deed of trust. The court found it "not reasonable" for Zinvest to assume that the Bloomington address was Wells Fargo's last known available address, given the two recitals in the deed of trust saying that the Iowa post office box was the lender's address for notices.

Escrow Matters

Customer May Proceed in Suit Against His Bank for Wire Transfer Fraud

Jakob v. JPMorgan Chase Bank, N.A., ___ F.Supp.3d ___, 2022 WL 16798071 (E.D.N.Y. 2022) (permanent citation not yet available).

A New York court has ruled that a customer may proceed in his suit against his bank for having completed a wire transfer to a fraudster even though the customer immediately halted the wire.

William Jakob contracted to buy Florida real estate. In November 2021, Jakob asked his bank, JPMorgan Chase Bank, to wire about $336,000 to what he believed to be the seller's bank account, based on wire transfer instructions he received. A few minutes later, the seller told Jakob that the money had not arrived. It appears that Jakob then deduced that the wiring instructions he had given to Chase were fraudulent.

Jakob sent an email to Chase, telling it not to wire the money to the fraudster's account. That email was sent 34 minutes after email requesting the wire transfer. The bank did not rescind the wire. Jakob lost his money.

Jakob sued JPMorgan Chase for breach of contract, conversion and bad faith conduct. This decision was issued on the bank's motion to dismiss.

The bank's first argument was that Jakob's breach of contract claim should be dismissed because UCC Article 4A preempted it. Jakob's claim was based on the terms of the wire transfer agreement Jakob and the bank entered into when the wire transfer was requested.

The court agreed that Article 4A governs the processing of a funds transfer request. However, the court said that, to the extent that Jakob's breach of contract claim was based on the bank's

Continued on Page 11

Continued From Page 10

actions "before and after the processing of the wire transfer, such claims are not preempted," quoting *Pedersen v. MidFirst Bank*, 527 F. Supp. 3d 188, 193 (N.D.N.Y. 2021). The court said that Jakob's claim hinged on his request "to cancel the wire transfer before it was processed in accordance with the terms of the Wire Transfer Agreement," and thus the UCC does not preempt his claim.

The bank also argued that the breach of contract claim should be dismissed because the bank had complied with Section 211 of the UCC, which says:

> … [A] communication by the sender cancelling or amending a payment order is effective to cancel or amend the order if notice of the communication is received at a time and in a manner affording the receiving bank a reasonable opportunity to act on the communication before the bank accepts the payment order.

The bank argued that the "critical question" was whether Jakob sent the cancellation request before or after the bank initiated the wire. The court said this was a fact question that could not be decided on a motion to dismiss. Jakob alleged that he had sent the cancellation request "immediately." He had first initiated the wire at 4:26 p.m. He alleged that he told the bank to cancel the wire transfer 34 minutes later. The complaint did not say when the bank initiated the wire. The court noted that the bank closes at 5:00 p.m. and that, if the bank initiated the wire the next morning, Jakob would likely prevail on his claim. The court cited *Phil & Kathy's v. Safra Nat'l Bank of N.Y.*, 595 F. Supp. 2d 330, 333 (S.D.N.Y. 2009), which said that the UCC "clearly states that a sender may amend or cancel a payment order prior to acceptance."

The bank's final argument about the breach of contract claim was that it had not breached the Wire Transfer Agreement. That agreement told Jakob that he could cancel the wire within 30 minutes at no cost to him. However, if the request came after that time, and if the bank had "begun processing" the wire, the money would only be returned if the recipient bank agreed. The court said this argument was not a basis on which to dismiss the claim, because the timing of the events was yet to be seen.

The court did dismiss Jakob's claims for conversion and bad faith conduct. It said the conversion claim was duplicative of the breach of contract claim. Also, money is fungible, and New York case law says that money deposited in a bank account is not the kind of "specific" and "identifiable" property for which a conversion claim may be brought.

The court said that Jakob's commercial bad faith claim failed because such a claim against a bank requires proof that the bank was knowingly involved in a scheme with the bad actor to defraud the customer. *MLSMK Inv. Co. v. JP Morgan Chase & Co.*, 737 F. Supp. 2d 137, 145 (S.D.N.Y. 2010), said that such a claim applies when a "bank acts dishonestly—where it has actual knowledge of facts and circumstances that amount to bad faith, thus itself becoming a participant in the fraudulent scheme." Jakob had not made allegations to support such a claim, which is subject to the heightened pleading requirements for claims of fraud.

A comparison of this decision to the *Approved Mortgage* opinion, also reported in this issue, shows the many varieties of wire transfer fraud that property owners now face. For example, the *Jakob* decision did not mention any title or closing agent, and the money was being wired directly to the seller. This decision also illustrates the importance of *immediate* action after wire transfer fraud has been detected.

Escrow Matters

Bank Not Liable For Delivering Wired Money to Fraudster

Approved Mortgage Corp. v. Truist Bank, ___ F.Supp.3d ___, 2022 WL 16635290 (S.D.Ind. 2022) (permanent citation not yet available).

A bank is not required to reimburse the sender for having accepted two wire transfers into a fraudster's account, and immediately paying the money out to the fraudster, despite evidence that the account was suspicious.

In 2021, Approved Mortgage Corporation received two payoff requests from existing borrowers, named Singh and Nagra. Both borrowers were getting refinance loans from Huntington Mortgage Company. The requests were both sent by MVP National Title Company.

A hacker had gained access to Approved Mortgage's email system. The hacker sent altered payoff statements to MVP Title. The title company, in turn, instructed its bank, BankUnited, to send wire transfers to the account listed on the payoff statements. The aggregate amount sent was over $500,000.

The altered payoff statements were in the name of Approved Mortgage. Approved had its bank account at SunTrust Bank (now Truist Bank). The hacker changed the account number on the wiring instructions to an account controlled by AER Operations, LLC. AER had just been formed as a company, and had just opened an account with SunTrust in order to impersonate Approved Mortgage. The hacker did not change the address listed on the payoff statements, which was Approved Mortgage's correct address in Columbus, Ohio. The bank knew, however, that the address listed for AER in the SunTrust account record was a (fake) address in Tillamook, Oregon.

Approved Mortgage alleged that little money had passed through the AER account before the two wires hit, and that SunTrust had previously stopped a wire transfer to the AER account "due to possible fraud or other irregularity."

SunTrust accepted the two wires. Immediately afterward, Arthur Rubiera, AER's registered agent, traveled from Oregon to a SunTrust branch in Memphis, Arkansas and convinced the teller to issue cashier's checks that cleaned out the account. Rubiera mailed the checks to someone else.

Continued on Page 12

Continued From Page 11

Ultimately, "the funds landed in the hands of a perpetrator who converted the funds into cryptocurrency," at which point the paper trail ended. One can only hope that the fraudster put all of the money in FTX currency.

After the Singh and Nagra money was stolen, Approved Mortgage replaced the money and paid off their loans so that the refinances could take place. Approved Mortgage took an assignment of MVP Title's rights against SunTrust Bank.

Then Approved Mortgage sued SunTrust (now Truist Bank) under the Uniform Commercial Code and for negligence. In this decision, the court dismissed all claims against the bank.

The UCC argument hinged on Section 207 of Article 4A of the Code, which Indiana adopted without changes as Section 26-1-4.1-207 of the Indiana Code. Approved Mortgage relied especially on an Official Comment to the UCC. Indiana did not adopt the Official Comments as a part of its version of the UCC, but Indiana courts often look to those comments for guidance. *BMO Harris Bank N.A. v. Salin Bank & Tr. Co.*, 442 F. Supp. 3d 1075, 1079 (S.D. Ind. 2020).

Under the definitions in Article 4A of UCC, MVP Title was the "originator," BankUnited was the "originator bank," and SunTrust was the "receiving bank" and the "beneficiary's bank." Fraudster AER was the beneficiary. Section 207(a) says:

> Subject to subsection (b), if, in a payment order received by the beneficiary's bank, the name, bank account number, or other identification of the beneficiary refers to a nonexistent or unidentifiable person or account, no person has rights as a beneficiary of the order and acceptance of the order cannot occur.

Official Comment 1 to Section 207 says that subsection (a) "deals with the problem of payment orders issued to the beneficiary's bank for payment to nonexistent or unidentifiable persons or accounts." The Official Comment explains:

> Since it is not possible in that case for the funds transfer to be completed, subsection (a) states that the order cannot be accepted. Under Section 4A-402(c), a sender of a payment order is not obliged to pay its order unless the beneficiary's bank accepts a payment order instructing payment to the beneficiary of that sender's order. Thus, if the beneficiary of a funds transfer is nonexistent or unidentifiable, each sender in the funds transfer that has paid its payment order is entitled to get its money back.

However, subsection (b) of Section 207 trumps (a) if the beneficiary exists, and the payment order identifies it both by name and bank account number, but the name and account number are for different people. In that case, the bank typically is allowed to rely on the account number in deciding where to deliver the money. However, if the beneficiary's bank "knows" that the name and account number do not match, the beneficiary is not entitled to receive the payment, and "acceptance of the order cannot occur."

Approved Mortgage asserted that this wire transfer fell under subsection (a), and that MVP Title was thus "entitled to get its money back" from Truist Bank. For its part, Truist argued that subsection (b) controlled, that Approved Mortgage had not alleged that Truist had actual knowledge that the address listed in the wire transfer order belonged to AER and not Approved Mortgage, and therefore the bank was entitled to rely on the account number alone and deliver the money into the AER account.

Truist also argued that neither Approved Mortgage nor MVP Title was in privity with Truist, and therefore Approved Mortgage could not sue Truist despite the assignment from MVP Title. Truist's argument was that Article 4A only allows a sender to seek a refund from the receiving bank it paid, so that only BankUnited could pursue relief against Truist. Approved Mortgage argued in response that Section 207(a) does not contain a privity requirement.

The court sided with Truist on the privity issue, and never reached the issue of which subsection applied. It looked to Section 402 of the Code, which says that when a sender bank was not obligated to make a payment, as in this case, "the bank receiving payment is obliged to refund payment to the extent the sender was not obliged to pay." Truist relied on *Grain Traders, Inc. v. Citibank, N.A.*, 160 F.3d 97, 102 (2d Cir. 1998). The court quoted the Second Circuit's statement in *Grain Traders* that it would be bad public policy to allow a party to "skip over the bank with which it dealt directly, and go to the next bank in the chain," because that could somehow create uncertainty or "a risk of multiple or inconsistent liabilities."

Approved Mortgage protested that it made no sense to sue BankUnited, because it had no power to detect the fraud and did not pay the fraudster. Approved said this case fell under the fraud hypothetical in UCC Official Comment 2, having similar facts, which concludes that "Beneficiary's Bank takes the loss." The court gave this circular reasoning in rejecting that position:

> Here, Approved Mortgage relies on the statement in this hypothetical that "Beneficiary's Bank"—which on these facts, is Truist—"takes the loss." But nothing in the hypothetical suggests that Beneficiary's Bank must refund Mutual Fund (the originator) directly. Instead, Mutual Fund (the originator) is excused from its obligation to pay Originator's Bank, meaning in this case Approved Mortgage (standing in the shoes of MVP Title) would be excused from its obligation to pay BankUnited (originator's bank). BankUnited, in turn, is not obligated to pay Truist. Truist, therefore, would "take[ ] the loss" and be required to recover the amount that it refunded to BankUnited from the party responsible for the fraudulent transfer, perhaps the hackers or Mr. Rubiera.

The court did not bother to explain in what sense Truist would "take the loss" after the court dismissed the action. As to Approved Mortgage's appeal to common sense, the court gave this weak reply, in effect admitting that the UCC is a statutory creature not built on a bulwark of common sense:

Continued on Page 13

Continued From Page 12

> [Approved Mortgage] asserts that "incorporating a privity requirement does not make sense," essentially because it believes that Truist—not BankUnited—is the "wrongdoer" in this case.… But Approved Mortgage's policy concerns notwithstanding, the text and structure of Section 207 and Section 402, for the reasons explained in *Grain Traders*, preclude Approved Mortgage from recovering from Truist in these circumstances. And it does "make sense," given that Section 207 and Section 402 provide for an orderly unravelling of the wire transfers, which directs each party in the chain of transactions to recover from only the next party in line. … Approved Mortgage cannot make an end run around these rules by suing Truist directly.

The court also dismissed Approved Mortgage's negligence claim. It held that the basis for that claim was in the payment of the wire transfer and not other negligent acts. Therefore, the court said, Article 4A of the UCC preempted the negligence claim.

The court's predilection in favor of the bank appeared in the first sentence of this opinion, in which the court set up its own view of cause and effect:

> The computer system belonging to Plaintiff Approved Mortgage … was infiltrated by hackers, which set off a chain reaction of events resulting in the payment of over half a million dollars to a third party by Defendant Truist Bank.…

Escrow Matters

Choice of Forum Provision in Escrow Agreement Trumps Conflicting Term in Purchase Agreement

In re Siluria (Assignment for the Benefit of Creditors), LLC, 2022 WL 11485467 (Tex.App.-Beaumont) (unpublished).

When a buyer and seller signed a purchase and sale agreement and an escrow agreement for that sale at the same time, specifying that lawsuits must be filed in two different states, the forum choice stated in the escrow agreement controlled as to a dispute over only the escrow.

Siluria LLC and Lummus Technology LLC signed an asset purchase agreement that said that the agreement was governed by California law and that any disputes would be litigated in that state, and that both parties waived the right to a jury trial. At the same time, the companies signed an escrow agreement for the deposit of the purchase price or earnest money. The escrow agreement permitted the escrow agent to interplead the escrowed money in a court in Montgomery County, Texas, and said that the escrow agreement was governed by and enforced in accordance with Texas law. The escrow agreement did not contain a jury trial waiver.

The contract fell apart. The escrowee filed an interpleader action in Texas. The creditors of Siluria petitioned for a writ of mandamus to compel the trial court to enforce the jury trial waiver in the interpleader action. They relied on *In re Prudential Ins. Co. of America*, 148 S.W.3d 124 (Tex. 2004), in which the high court said that "agreements executed at the same time, with the same purpose, and as part of the same transaction, are construed together." The Prudential court found that a jury waiver in a lease was incorporated into a guaranty of that lease.

The trial court refused to impose the jury trial waiver in the interpleader action. Siluria appealed. The appellate court affirmed, and distinguished *Prudential*. It said:

> Here, the Asset Purchase Agreement expressly provided for California choice of law and forum and waived trial by jury for any disputes arising in connection with the parties' agreement, but the interpleader action authorized by the Escrow Agreement expressly provided for Texas choice of law and forum without a jury waiver. In the Interpleader action, neither party has asserted any claims under the Asset Purchase Agreement. Thus, *Prudential* is distinguishable from the facts before this court.

This short decision might be very useful. An escrowee has some control over the terms of the escrow agreement or instructions, but no control over the purchase agreement, which is already signed before the escrow is formed. The escrowee has a legitimate desire to have any escrow dispute decided by a court that is local to the escrow company, while often the parties are based in other states. A forum selection provision in the escrow agreement should be enforced in an escrow dispute. The holding also relieves the escrow company of the burden of parsing out the terms of the purchase agreement, and trying to figure out if that contract's terms override the terms of the escrow agreement.

Escrow Matters

Construction Disbursing Service Owes No Duty to Builder

Henry Adams, Inc. v. U.S. Bank, N.A., ___ F.Supp.3d ___, 2022 WL 17097002 (W.D.Ark. 2022) (permanent citation not yet available).

A lender and its title agent construction loan supervisor owed no duty to the builder, and the court has dismissed all claims brought by the builder other than a claim of tortious interference with the building contract.

Brandi Dodgen contracted with Henry Adams and his company, Henry Adams, Inc., to build a home on a lot in Green Forest, Ark. Dodgen got a construction loan from U.S. Bank. The bank hired Great American Title Company LLC to act as its disbursing agent and draw supervisor.

The building contract was short and vague. U.S. Bank insisted that Adams provide more detail about the plans,

Continued on Page 14

Continued From Page 13

specifications and scope of the project. Adams produced several more versions of the contract, but never included enough specifics to make the bank comfortable. Three U.S. Bank employees, a Great American Title person and Adams had a phone call, in which Adams admitted that he did not have a computer or an email account. The bank agreed to allow Adams to bring his invoices to the Great American Title office, so that the title employee could help him manually fill out the spreadsheets, draw requests and other documents for each draw.

Adams filled out and submitted the papers for two draw requests. Each time, the bank funded less than the amount requested. After the second draw, Dodgen refused to approve draws, accusing Adams of shoddy workmanship and requesting reimbursement for items that Dodgen had paid for herself. Dodgen also sent the bank a letter labeling Adams' final draw request as "offensive" and "fraudulent," in part because he sought payment for items that Dodgen had bought.

Adams filed a mechanic's lien against the house, and then sued Dodgen to foreclose the lien. That action was dismissed. Then Dodgen sued Adams for negligence, breach of contract and other claims. Adams counterclaimed for the money he says he is owed. That case is still pending.

In June 2022, Adams sued U.S. Bank and Great American Title in federal court, for promissory estoppel, negligence, breach of fiduciary duty, and tortious interference with his contract with Dodgen. In this decision, the court ruled on the defendants' motion to dismiss.

Adams' promissory estoppel claim was based on the assertion that the bank and its disbursing agent had promised Adams that he would be paid "the guaranteed contract price of $199,500" under the Dodgen contract, and that "U.S. Bank's disbursement procedures would be followed." The court said this claim was "clearly implausible." It said:

> HAI [Adams] claims it relied on a promise all Defendants allegedly made that HAI would be paid every dollar demanded, without any meaningful inquiry into the nature of HAI's expenditures or performance and without input from Ms. Dodgen—the borrower on the construction loan. A close review of the Complaint makes clear that Defendants made no such promise. Instead, the Complaint claims that Defendants failed to "inform Adams that he would not be paid the guaranteed payment of $199,500 dollars or inform Adams that it would treat the construction contract as a cost-plus or as time and material." … In other words, HAI would have the Court believe that a "failure to inform" is the same as a "promise to pay."

The court said that, rather than having relied in good faith on a promise made by the bank, Adams had merely "made several assumptions about how it would be paid for construction services." Thus, his claim failed.

The court dealt Adams' negligence claim the same fate, based on a similar analysis. Adams alleged that the bank and Great American Title had voluntarily assumed a duty of care toward him, by communicating with Adams about the draws and the project, and assisting him in filling out the draw paperwork. He then claimed that the bank breached that duty by not curing the problems with his documents to cause him to be paid everything he claimed to be owed.

The court refused to wade into the details of Adams' claims. It cited Arkansas case law holding that a bank owes a duty to use ordinary care in dealing with its customers, but owes no duty of care to non-customers. It cited *Arloe Designs, LLC v. Ark. Capital Corp.*, 2017 Ark. 21, 6 (2014); *Quintero Cmty. Ass'n Inc. v. F.D.I.C.*, 792 F.3d 1002 (8th Cir. 2015); and *Old Republic Nat. Title Ins. Co. v. Landmark Closing Co.*, 2010 WL 2228436 (E.D. Ark. June 1, 2010). Because there was no duty, Adams' negligence claim failed.

The court also dismissed Adams' breach of fiduciary duty claim. It found analogous the case of *Country Corner Food and Drug, Inc. v. First State Bank and Trust Co. of Conway,* 332 Ark. 645, 654 (1998). In that case, an unsophisticated borrower claimed that a bank breached a fiduciary duty by falsely representing that a note would be renewed, avoiding foreclosure. The Arkansas Supreme Court affirmed dismissal of the case because the borrower had not proven that there was a relationship between the bank and its customer that was "more than a debtor/creditor relationship," which is necessary to establish a fiduciary duty. This court said that Adams' claim failed because he and the bank "did not even have a debtor/creditor relationship—let alone the something 'more' that the law requires for a fiduciary duty." The court reminded Adams that *Country Corner* said that a party's "[l]ack of sophistication" that results in it being "misled" is insufficient, as a matter of law, to create a fiduciary relationship.

The court did not dismiss Adams' claim that the bank and Great American Title had interfered in Adams' building contract with Dodgen. The court found that Adams had pled allegations that supported the four required elements for such a claim, although it said it was "skeptical" about Adams' chance of prevailing on the claim. However, the court stayed this action until the Dodgen-Adams lawsuit is finished, to avoid the possibility of double recovery by Adams.

This is one of the few decisions involving claims against a title company construction disburser. Other decisions in agreement include: *Hoida, Inc. v. M & I Midstate Bank*, 291 Wis.2d 283, 717 N.W.2d 17, 2006 WI 69 (Wis. 2006) (disburser not liable to contractor even when negligent in performing servicers for lender); *Superior Construction Services, Inc. v. Moore*, 2007 WL 1816096 (Minn.App.) (unpublished) (bank escrowee disbursing insurance proceeds for repairs owed no duty of care to contractors to assure that they would be paid); *P.E.M. Construction & Development Co., Inc. v. EnCap Gold Holdings, LLC*, 2011 WL 3802244 (N.J.Super.A.D.) (unpublished) (subcontractor not an intended third-party beneficiary of construction project escrow, and not entitled to be paid when conditions for disbursement not met); *Christenson v. Commonwealth Land Title Ins. Co.*, 666 P.2d 302 (Utah 1983) (contractor not in privity with construction loan disburser and disburser owes it no duty other than to refrain from misrepresenting the facts); and *Bescor, Inc. v. Chicago Title & Trust Co.*, 113 Ill.App.3d 65, 68 Ill.Dec. 812, 446 N.E.2d 1209 (Ill.App. 5 Dist. 1983) (subcontractor not a third party beneficiary of construction escrow).