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Title Insurance

Insurer Had No Duty to Defend Insureds in Suit About Land Not Insured

Rabinowitz v. Chicago Title Ins. Co., 2020 WL 4783745 (Wash.App. 2 Div.) (unpublished).

A title insurer was not required to pay for a lawsuit against its insureds over ownership of a parcel next to the insured land.

Neil and Elizabeth Rabinowitz have owned a house on Bainbridge Island in the State of Washington since 1987. The island is part of the Puget Sound. William and Sara McGonagle own the property next door.

The Rabinowitz deed described their parcel by metes and bounds. The description carved out a strip of land using these words: "LESS the East 10 Feet reserved for road for use of the Granter of the tract immediately adjoining on the South."

The Rabinowitz and McGonagle parcels had been one parcel until 1915. The 10-foot parcel was excepted in the 1915 deed splitting out the Rabinowitz parcel, and in every deed since then. The court reported that the common owner conveyed the McGonagle parcel in 1915 also, but that deed "made no mention of the 10-foot strip." Likewise, the deed to the McGonagles "did not mention the 10-foot strip, although the strip is essential to accessing the McGonagle property from the public road."

The Rabinowitzes got a policy from Chicago Title when they bought. The legal description in Schedule A was identical to that found in their deed. The policy contained Schedule B exceptions for easements not found in the public records, and two recorded easements.

In 2011, the McGonagles sued the Rabinowitzes. Their first claim was ownership of the 10-foot strip, based on the assertion that that parcel had been omitted from their deed by mistake. In the alternative, they claimed that the Rabinowitzes owned the area, subject to a prescriptive easement in favor of the McGonagles.

The Rabinowitzes tendered their defense to Chicago Title. The insurer refused to defend the lawsuit or pay a loss, because the lawsuit concerned a parcel whose title was not insured in the policy. The court later ruled that the McGonagles owned the ten-foot strip.

In 2015, the Rabinowitzes sued Chicago Title, claiming that it breached a duty to defend them and did so in bad faith, and demanding reimbursement of their defense costs. The Rabinowitzes also claimed that Chicago Title violated the Washington Consumer Protection Act and the Insurance Fair Conduct Act, breached an alleged quasi-fiduciary duty, caused negligent infliction of emotional distress, and owed them coverage by estoppel.

The trial court dismissed all the

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The Title Insurance Law Newsletter, 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***.

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Rabinowitz claims on summary judgment. The appeals court affirmed.

In Washington, an insurer has a duty to defend its insured in litigation if the complaint contains allegations that are "conceivably covered." An insurer must defend "if a claim would be covered under any reasonable interpretation of the facts or law." However, while the duty to defend is broad, it is not unlimited. The insurer "does not owe the insured a duty to defend if it is clear from the face of the complaint that the claims do not fall within the policy." The eight-corners rule is used to determine the duty to defend. If the review of the allegations in the complaint does not clearly indicate "conceivable coverage," the insurer "may defend under a reservation of rights without breaching the contract while the question of coverage is resolved in a separate action." One of the leading sources cited by the court was *Campbell v. Ticor Title Ins. Co.*, 166 Wn.2d 466, 209 P.3d 859 (2009).

The court first analyzed the duty to defend the McGonagles' claim to own the ten-foot strip, on which they prevailed at trial. The Rabinowitzes argued that Chicago Title did not analyze the duty to defend this claim correctly, because it "made a self-serving determination" that the policy did not insure the title to the disputed land. They also argued that their legal description was ambiguous, and that this obligated Chicago Title to assume that the policy insured the title to the land. They also argued that Chicago Title's determination that the policy did not insure title to the land was wrongly based on extrinsic evidence about a disputed material fact.

The court said that the four corners of the complaint did not allege any competing interest in land owned by the Rabinowitzes:

> *The McGonagles' fee simple claim is not conceivably covered under the Rabinowitzes' title policy because, if the McGonagles' allegations are considered as proven, the title policy accurately described the disputed land as belonging to the McGonagles and not to the Rabinowitzes.*

The court observed that the complaint alleged that the McGonagles owned the strip precisely because that land was carved out of the Rabinowitz description. Without the exception stated in the Rabinowitz deed, "the McGonagles would have no basis to claim that omission of the 10-foot strip from their own deed was a scrivener's error."

The court then compared the allegations in the four corners of the complaint to the coverage within the four corners of the policy, and concluded that they aligned:

> *If the McGonagles' fee simple claim is proven, then the Rabinowitz deed expressly excludes the 10-foot strip from the Rabinowitzes' property. Because the legal description in Schedule A contains identical language to the Rabinowitzes' deed, then Schedule A must also be interpreted as excluding the strip. Therefore, title would not vest "otherwise than as stated," because the title policy accurately described the Rabinowitz property, and this claim is not covered.*

The court also rejected the claim that the policy was ambiguous. It noted that words in an insurance policy may not be given an absurd construction, and are "read from the perspective of an average person." An average person could conclude that the policy did not insure the title to the disputed strip:

> *Here, the legal description of the Rabinowitz property, as copied in Schedule A of the title policy, defines the boundaries of the property and includes the phrase, "LESS the East 10 feet reserved for road for use of the Grantor of the tract immediately adjoining on the South." … An average person would interpret the capitalized word "LESS" to indicate that the land described thereafter is not included within the boundaries of the property owned in fee simple without any encumbrances. Therefore, interpreting this language as granting the Rabinowitzes' an unencumbered fee simple interest to the 10-foot strip would result in an absurd construction. Because the Rabinowitzes would not face any loss or liability if the McGonagles' express easement claim was proven as alleged, this claim is not conceivably covered, and Chicago Title did not owe a duty to defend.*

The court separately analyzed the McGonagles' alternate claim to hold an easement over the ten-foot strip. The Rabinowitzes made a truly extraordinary claim in this regard:

> *Here, the Rabinowitzes argue that the express easement claim is covered because if the McGonagles' express easement claim is*

considered as proven, they would have a fee simple interest in the strip subject to an express easement as opposed to no interest in the strip at all. The Rabinowitzes claim that this distinction triggers the provision in their policy that provides coverage when "[t]itle to the estate or interest described in Schedule A [is] vested otherwise than as stated therein." …[T]he Rabinowitzes contend that title to the strip would have "vested otherwise than as stated" in Schedule A, triggering coverage, because Chicago Title asserted that according to Schedule A, they have no interest in the strip at all. … The Rabinowitzes also argue that title vested "otherwise than as stated" because this easement was not included in the exceptions to title portion of their title report, although other easements were listed.

The court responded that, if the McGonagles had proven that the Rabinowitzes owned the strip, the insurer would not have had a duty to defend because ownership of the strip would not cause a loss to the Rabinowitzes. It said:

The purpose of title insurance is to protect the insured from a loss arising from a defect in the title. … The title insurer protects against such losses through search and disclosure of any potential encumbrances, defects, liens, adverse claims, or similar issues. … The duty to defend is based on the "potential for liability" arising from a loss covered by the insurance policy. … Therefore, the duty to defend is not triggered merely when the complaint contains allegations that may conceivably be proven. … Instead, these allegations, if proven, must also result in a loss or liability that is conceivably covered under the insured's policy. … [The] policy expressly excludes from coverage any "[d]efects, liens, encumbrances, adverse claims, or other matters... (c) resulting in no loss or damage to the insured claimant."

* * * *

Even if we agree with the Rabinowitzes that their title vested otherwise than as stated in Schedule A, because rather than having no interest in the disputed property, they would have an encumbered fee simple interest subject to the McGonagles' easement, they fail to show that they would suffer loss or liability resulting from this claim. This is so because the only way they could suffer a loss is if the interest they had to begin with was greater than the interest they would retain if the McGonagles' express easement claim is proven.

The court concluded that Chicago Title had no duty to defend the Rabinowitzes as to either claim pled by the McGonagles.

The only way in which this analysis could have been improved would have been for the court to plainly declare that a legal description taken verbatim from the insured's deed is not a term of the title insurance policy, and that any claimed ambiguity in the description is not construed against the insurer as "drafter."

Chicago Title was ably represented by Henry Kerr Hamilton, of Fidelity National Law Group in Seattle.

Title Insurance

Insurer Not Estopped From Denying Coverage by Statement That Claim Might Be Covered

Pasha v. Eisele, 2020 WL 4555812 (Ky.App.) (unpublished).

In addressing a legal malpractice claim, the Kentucky appeals court has held that a title insurer was not equitably estopped from denying a claim based on an exception after stating that the claim was "potentially covered." Of interest to attorney agents, the court also held that buyer insureds were far too late in suing their lawyer for failing to locate a document in his title search.

Sasan Pasha and Maren Schulke bought property in Lexington in 2009. They hired lawyer Brent J. Eisele to represent them in the purchase. Eisele conducted a title search and examination. He told Pasha and Schulke that the property's zoning would allow the construction of a multi-story building.

Closing occurred on May 8, 2009. Pasha says that he learned on May 26 that there was a recorded restriction prohibiting a structure of more than one story. Pasha asked Eisele to try to get the restriction removed, which did not work. Eisele told Pasha that the restriction had not been properly indexed, and that the insureds should make a claim on their title insurance policy.

The insureds made that claim. In *Pasha v. Commonwealth Land Title Ins. Co.*, 2014 WL 5510931 (Ky. App.) (unpublished), reported in the January 2015 issue, the court held that coverage for the restriction was negated by an exception for "[a]ny easements or servitudes appearing in the public records."

In 2011, when the buyers hired a new lawyer to sue Commonwealth, they talked to that lawyer, Edwin Bornstein, about suing Eisele also. Bornstein told them that they had already blown the one-year statute of limitations for a malpractice claim against Eisele.

In 2016, Pasha and Schulke sued both Eisele and Bornstein for malpractice. In this decision, the appeals court affirmed summary judgment in favor of both lawyers.

The court addressed the claim against Eisele first. The legal malpractice statute of limitations is Kentucky Revised Statute 413.245, which says that such an action must be brought within one year from the date of the malpractice act or "from the date when the cause of action was, or reasonably should have been, discovered by the party injured." The Kentucky courts break this down as two dates, the "occurrence" date and the "discovery" date.

The appeals court said that the occurrence date was the date of the title examination, which was conducted on or before the closing date of May 8, 2009. It rejected the owners' claim that the "occurrence" date is the date on which the damage from the alleged

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malpractice becomes fixed or quantifiable. The court said the owners knew they had been harmed in some amount when they discovered the restriction on May 26, 2009. The court said that date was also the discovery date.

Pasha and Schulke argued that the discovery date was the date on which Eisele first argued, in a brief, that he was not negligent in his title search because the restriction was not properly indexed. The court rejected that claim also, because the owners knew in May of 2009 that Eisele had missed the restriction in his title search, for whatever reason. "At that point, the court said, "they were on notice that they may have been inadequately represented and had a duty to use due diligence to discover whether Eisele was negligent."

The court also rejected Pasha and Schulke's claim that the "continuous representation" rule should apply. That rule is used in legal malpractice cases when the same lawyer represents the clients for some time, and fails to inform the client of the facts that would evidence his or her malpractice. The court said that Eisele's representation of Pasha and Schulke ended at the closing, noting that Bornstein handled the lawsuit against Commonwealth. Thus, that rule did not extend the statute of limitations.

The court addressed the coverage determination letter in affirming the grant of summary judgment in favor of Bornstein. Pasha and Schulke argued that Bornstein had committed malpractice by failing to preserve for appeal the argument that Commonwealth was estopped to deny their claim. The insureds' argument was that the insurer was barred from denying the claim because the first coverage determination letter said that the restriction issue appeared to be "potentially covered," and later coverage letters raised the "no loss" exclusion but not the exception for recorded servitudes. The insureds had argued that these letters misrepresented that there was coverage, after which the insurer was estopped to deny coverage under the exception.

In this decision, the court said that Bornstein had not committed malpractice because the estoppel argument had no merit. It said the coverage letters were not misrepresentations and the insurer consistently reserved the right to raise other coverage defenses. The court provided this quotable analysis:

> *Appellants' equitable estoppel argument is that Commonwealth Land Title believed throughout the case against it that the public record exclusion ap plied but concealed that belief. Even if true, Commonwealth Land Title did not make a false misrepresentation or conceal a material fact. … Commonwealth Land Title's opinion that the alleged loss could "potentially be a covered matter under the policy" was just that, an opinion, and not a material fact. Moreover, Commonwealth Land Title did not conceal that it reserved the right to assert any additional defenses. It repeatedly informed appellants that it reserved that right. Finally, even if appellants could establish all other elements of equitable estoppel, it is undisputed that not only were appellants aware of Commonwealth Land Title's reservation of any and all defenses, appellants had the means to discover what those defenses might be. As we noted in Pasha, the plain language of the policy set forth the exclusion ultimately relied on by Commonwealth Land Title. Pasha, 2014 WL 5510931, at *4. Even if Bornstein had presented the equitable estoppel argument earlier in the Commonwealth Land Title case, appellants would not have fared better in that action.*

This decision is perhaps the best discussion of why a title insurer is not prevented from asserting a valid coverage defense after reaching the initial conclusion that a matter may be covered. It is also a strong endorsement of the modern practice employed by title insurers of reciting in the coverage determination letter that the insurer reserves the right to raise coverage defenses at a later time.

Title Insurance

Title Agent May Choose to Recover Fees from Indemnitors

Halprin v. Federal Deposit Ins. Corp., ___ F.Supp.3d ___, 2020 WL 4572929 (W.D.Tex. 2020) (permanent citation not yet available).

A title agent that paid a lot of money to defend itself against claims emanating from the fraudulent sale of development land to investors may recover its fees from people who gave indemnities to induce the insurer to cover the risk, despite the indemnitors' plea that the insurer be allowed to seek payment only from the fraudster.

As was reported in the November 2018 and March 2020 issues, HTG Real Property Management, the Padilla Property Corp., Mauro T. Padilla III and others contracted to sell property investments to 37 people, including Gregory Halprin. The Padillas agreed to build apartment buildings on the lots they sold to the buyers in Texas. The buyers delivered down payments to escrowee LandAmerica Lawyers Title of San Antonio Inc. The Padillas deeded the lots to the buyers and started constructing the buildings.

Not long afterward, however, the Padillas asked the buyers to deed the lots back so they could get construction financing, and to subordinate their ownership rights to those of the construction lender. The buyers unwisely did so. The Padillas got the construction loan and spent the money elsewhere. They did not finish the apartment buildings. The lender foreclosed, wiping out the investors.

LandAmerica would not handle the escrows for the deeds and construction loan unless the investors indemnified it against claims that might be made based on the risky deed-back plan.

The investors sued the Padillas and American Title Group Inc., the successor to LandAmerica Lawyers Title of San Antonio, for its escrow acts.

American Title sued Mauro Padilla to recover its attorneys' fees in defending against the buyers' claims, under the Texas Deceptive Trade Practices Act. Section 17.555 of the DTPA allows a person who has been roped into an action under that law to obtain indemnity from the person who caused the problem, including the attorney's fees incurred by the non-guilty party. American Title also brought claims against the investors who had given indemnities.

In this decision, the court permitted American Title to drop several claims, and to pursue only the investor-indemnitors for its attorney fees. Texas law allows a prevailing party to elect to take the alternate of two remedies that affords "the greatest or most favorable relief." The indemnitors argued that American Title should not be able to use election of remedies in this case because it was seeking a remedy against two different persons, and the nature of the remedies was different. The court agreed that American Title would be barred from recovering twice by pursuing the same money from two sources. However, it was not seeking double recovery, because it dismissed its contribution claim against Mauro Padilla.

The court also provided an extended analysis of what attorneys' fees American Title was permitted to recover, which entailed parsing out which fees were incurred in defending against the plaintiff investors' claims against it and which were incurred in pursuing the Padillas. The court also performed a lodestar analysis.

Scott A. Wheatley of Jackson Walker represented American Title.

Title Insurance

Claim Payment Does Not Prevent Insured From Claiming to Own Land

Teonard v. Pantich, 2020 WL 5049098 (N.J.A.D.) (unpublished).

The fact that a property owner received payment from her title insurer for the "loss" of a strip of land bordering a neighbor's land was not a election of remedies that prevented her from suing the neighbor to assert ownership of the same land, says a New Jersey court.

In 2006, Cheryl Leonard bought a house in Elsinboro Township, N.J., an ancient settlement on the Delaware River. Her parcel is a lot in a platted subdivision. She got a survey showing the west boundary as being established by an iron pipe, and that the neighbor to the west had a fence along the rear portion of the boundary and a gravel drive running along the front part of the boundary.

Leonard later made a claim on her title insurance policy when she determined that the fenced area encroached on her parcel. The insurer paid her $600 as the value of the land enclosed by the fence.

Pera Pantich has owned the lot to the west of Leonard's house since 1981. In 2010, after the title insurer paid Leonard for the fenced-in land, Leonard sent a letter to Pantich telling him to remove the fence. Pantich replied that he would not, because the true boundary corner was at a white post, not the iron pipe, and his fence lined up with the post.

In 2015, Pantich placed new gravel on the driveway, which Leonard says slops over the boundary by "up to six inches away from the white post," and he rebuilt the fence at the rear. Leonard got a new survey that showed the new fence as encroaching by six inches onto her parcel.

Leonard sued Pantich in equity court, seeking an order requiring Pantich to remove the gravel and move the fence. Pantich counterclaimed, claiming the area by adverse possession. The case went to a trial. Pantich moved for involuntary dismissal under Rule 4:37-2. He argued that, because Leonard had been paid $600 for the disputed land by her title insurer, she was barred from bringing the quiet title action under the doctrine of election of remedies. Pantich also put on testimony about the boundary and the effect of moving it on his septic tanks and access to the property by fire and oil heat trucks.

The judge ruled in favor of Leonard, and ordered Pantich to remove the encroaching fence and driveway. She held that Leonard's settlement with her title insurer did not invoke the doctrine of election of remedy. The appeals court affirmed all of the trial court rulings, including that the title insurance payment did not prevent Leonard from claiming to own the land for which she was paid.

The appeals court noted that Pantich did not introduce the settlement agreement between Leonard and the title insurer as evidence at trial. Instead, his claim was based solely on Leonard's testimony on the stand, in which she said that she "believed [the title company] intended" to pay her for the loss as covered by a policy endorsement. The court said the title insurer might only have paid Leonard for the fence encroachment, not the driveway, since the first survey did not show the driveway as being an encroachment.

The court also said that, while "[t]he doctrine of election of remedies is recognized in New Jersey," it has long ago been "characterized [as] 'a harsh and now largely obsolete rule' and one 'to be strictly confined within its reason and spirit.'" The court quoted from *Collins v. U.S. Fidelity & Guar. Co.*, 384 N.J. Super. 439, 448 (App. Div. 2006), which in turn quoted from *Schrage v. Liebstein*, 16 N.J. Super. 384, 389 (App. Div. 1951). The court also cited the principle that "[t]he mere bringing of a suit asking one remedy rather than another practically never affords ground for an estoppel and is not sufficient reason to deny an application for an alternative remedy," from *Newark Paraffine Paper Co. v. Dugan*, 162 N.J. Super. 575, 578 (App. Div. 1978). The court thus reached this conclusion:

> *Here, plaintiff has essentially brought this suit seeking a remedy that was an alternative to that which she urged against her title insurer. She is not barred from doing so under the doctrine of election of remedies and it would be unreasonable and contrary to the spirit of that equitable doctrine to transfer ownership of plaintiff's property to defendant under the circumstances presented.*

Although title insurers see this phenomenon with fair regularity, this decision is one of the few to address the insured's right to seek to quiet title to land for which the insurer has already paid the insured.

Escrow Matters

Buyer Has No Claim Against Bank for Wire Transfer Fraud

Fragale v. Wells Fargo Bank, N.A., ___ F.Supp.3d ___, 2020 WL 4815804 (E.D.Pa. 2020) (permanent citation not yet available).

A federal court in Pennsylvania has dismissed all claims brought by a real estate buyer against a bank based on the buyer's delivery of purchase money to an account set up by wire transfer fraudsters.

Frank Fragale contracted to buy a house in Celebration, Florida as his retirement home. Equitable Title of Celebration LLC served as settlement agent. Shortly before closing, Fragale got a phishing e-mail from someone claiming to be with Equitable Title, attaching wire transfer instructions for an account at Wells Fargo Bank. Fragale sent $166,054.96 to that account. A person named Kelleen Chea maintained that account. The bank then honored a request to issue two cashier's checks from the account totaling $160,000.

Fragale sued Wells Fargo. In this decision, the court granted the bank's motion to dismiss his claims.

The court rejected the bank's first argument, which was that Fragale's negligence claim was preempted by Article 4A of the Pennsylvania Uniform Commercial Code. That article "is a comprehensive scheme enacted to govern electronic wire transfers," and displaces the common law to the extent that it runs contrary to the terms of the UCC. The court held that Article 4A governs only what occurs between the originator's wire fund instruction and the bank's acceptance of the wired money. In this case, Fragale said his claims against the bank were based on what it did in setting up the fraudster account and in cutting the cashier's checks. The court said this conduct was either before or after the wire transfer itself, and thus was not preempted by Article 4A.

The bank's second argument was that it owed no duty to Fragale. The court began by noting that "the Pennsylvania Supreme Court has not previously decided the issue of whether a bank, such as Wells Fargo, owes a duty to a noncustomer, such as Plaintiff." The federal court was thus required to predict how the state's highest court would resolve the issue. The court was required to consider Pennsylvania appeals court rulings as an indicator of how the supreme court would rule.

Fragale's argument was that Wells Fargo had a common law duty to avoid creating an unreasonable risk of harm to him, as a non-customer, based on two Pennsylvania Supreme Court decisions, *Dittman v. UPMC*, 196 A.3d 1036 (Pa. 2018) and *Anderson v. Bushong Pontiac Co.*, 171 A.2d 771 (Pa. 1961). The federal judge noted, however, that neither decision involved a bank or a bank's duty to a non-customer. It also observed that Fragale had not cited any decision from any state finding that a bank owed a duty to a non-customer. To the contrary, decisions from across the country, including Pennsylvania, have held that banks do not owe any duty of care to a person who is not a customer. The court cited, for example, *Commerce Bank v. First Union Nat'l Bank*, 911 A.2d 133, 139 (Pa. Super. Ct. 2006), which held that a bank does not have a duty to take action against a client's bank account when the bank suspects fraud, in order to protect a third-party bank from future similar fraudulent conduct.

Fragale showed that Wells Fargo was aware of the threat of wire transfer fraud, and how it can be prevented by a bank. He cited the fact that these situations have been widely reported. He identified the fact that, about a year before this incident, the FBI issued a Public Service Announcement about wire transfer fraud, and the American Bankers Association issued a number of publications over the last five years identifying the importance of banks in combatting wire transfer fraud schemes. Still, the court concluded that:

> *[Fragale] has not alleged anywhere near the degree of specific facts necessary to show that Wells Fargo was on notice of the likelihood that the Account was part of a fraudulent scheme to which a noncustomer like Plaintiff would fall victim. At most, Plaintiff has alleged that banks like Wells Fargo were generally on notice that such schemes exist. However, Plaintiff does not allege any facts to suggest that when Wells Fargo actually opened the Account, it should have been on notice that this particular account was being opened for criminal or fraudulent purposes.*
>
> * * * *
>
> *With respect to the withdrawal of the funds, Plaintiff alleges that Wells Fargo should have suspected fraudulent activity simply because the funds were "immediately withdrawn" from a recently opened account. These facts, however, are insufficient to place Wells Fargo on notice that it was "likely" that the withdrawals were part of some fraudulent scheme.*

The court also said that it could not justify imposing a duty on the bank because it thought that Fragale was in the best position to prevent this type of fraud:

> *[Fragale] was in communications with Equitable Title of Celebration, LLC ... with whom [he] communicated as to the funds to be transferred by him as part of the "closing" process. … A person in Plaintiff's position could have undertaken efforts to confirm with his own title company that the transaction was set to close, that the e-mail he received was in fact from his title company or an authorized agent thereof, or that the title company maintained a bank account at Wells Fargo. Plaintiff, however, does not allege any such actions on his part. Nor does he allege any other efforts on his own part to confirm that the account to which he was directed to wire $166,054.96 belonged to Equitable Title. Thus, Plaintiff was at least equally situated with Wells Fargo to prevent his harm.*

The court also found "the consistent, prevailing, nationwide caselaw persuasive as indicating that there is minimal public interest in imposing the requested duties on banks like Wells Fargo under these circumstances."

Escrow Matters

Escrow Agreement Not Void as an Ultra Vires Act

Mexico Infrastructure Finance, LLC v. Corporation of Hamilton, ___ F.Supp.3d ___, 2020 WL 4572679 (S.D.N.Y. 2020) (permanent citation not yet available).

A municipal corporation is not entitled to void an escrow agreement on the theory that it had no authority to enter into such an escrow, based on a court ruling that the corporation had no authority to sign another document in the same transaction.

In 2012, the Corporation of Hamilton, Bermuda signed a lease with Par-La-Ville Hotel and Residences Ltd. allowing Par-La-Ville to build a hotel on land owned by Hamilton. Mexico Infrastructure Finance LLC agreed in 2014 to make a loan of $18 million to Par-La-Ville as seed money for a much larger loan to be used to build the hotel. The Corporation of Hamilton signed a loan guaranty.

The Mexico money was deposited into an escrow account. A written escrow agreement was signed by Mexico, Par-La-Ville, Hamilton and the escrowee, The Bank of New York Mellon. Par-La-Ville and Hamilton later sent instructions to the bank to release the money. Par-La-Ville used the money to buy an Aston Martin and real estate in the United Kingdom, not to secure the larger development loan. Then Par-La-Ville defaulted on the loan.

Mexico demanded that Hamilton make good on its loan guaranty. The Judicial Committee of the Privy Council ruled that Hamilton did not have authority to sign the loan guaranty and that it was thus void. The Judicial Committee is the court of last resort for disputes concerning overseas territories in the United Kingdom.

The dispute then devolved to claims between Mexico, Hamilton, Bank of New York and others about whether the money should have been disbursed from escrow, and to whom. The escrow agreement stated that all claims concerning the escrow had to be brought in a New York court, and would be decided based on New York law. In the present decision, the court addressed several motions for judgment on the pleadings and summary judgment. Two rulings are of interest to escrow companies.

The court granted the bank escrowee's motion to strike Mexico's claim for breach of fiduciary duty, as being duplicative of its breach of contract claim. The court began by noting the many New York decisions holding that an escrowee has fiduciary duties to the escrow parties, such as *Qube Films Ltd v. Padell*, 2016 WL 881128 (S.D.N.Y. 2016), reported in the May, 2016 issue. However, New York courts have held that a breach of fiduciary duty claim is duplicative when it is based on the same allegations made in the plaintiff's breach of contract claim. See, for example, *N. Shipping Funds I, LLC v. Icon Capital Corp.*, 921 F. Supp. 2d 94, 105 (S.D.N.Y. 2013) and *Uni-World Capital, L.P. v. Preferred Fragrance, Inc.,* 43 F. Supp. 3d 236, 244 (S.D.N.Y. 2014).

Mexico sought to escape this rule based on the statement in *Takayama v. Schaefer*, 240 A.D.2d 21 (2d Dep't 1998) that an escrowee is also a trustee, and owes a duty to all benefited parties to deliver the escrowed money to the right person. The court said, however, that *Takayama* "clearly stated that the case involved a situation 'where the escrow agreement [was] silent as to [the escrow agent's] duties.'" In this case, by contrast, the escrowee's duties were carefully delineated in the escrow agreement, and Mexico's allegations as to both claims concerned the same contract terms. The court thus dismissed the fiduciary duty claim as duplicative.

Next, the court considered Hamilton's claim that the escrow agreement was void because Hamilton had no authority to sign it. The authority for that assertion was the Privy Council ruling that Hamilton's signing of the loan guaranty was and *ultra vires* act and thus void. Mexico retorted that the escrow agreement was not beyond Hamilton's statutory powers, and that in any event New York law controlled all terms of the escrow agreement.

This court rejected Hamilton's claim. It noted that the Bermuda trial court ruling affirmed by the Privy Council was "carefully limited" to the guaranty. The lease had been authorized by Bermuda statutes. The lease authorized Hamilton to terminate that agreement if Par-La-Ville did not get construction financing and build the hotel. The escrow agreement gave powers to Hamilton to assure that the lessee was getting that financing, and thus was incident to its statutory powers.

Despite the court's conclusion, this decision provides a stark warning to escrowees that there are special wrinkles when an escrow involves a governmental body, particularly one formed under and controlled by the laws of a foreign nation.

Escrow Matters

Escrowee Did Not Breach Duties by Interpleading Deposited Money

Silver Star Title, L.L.C. v. Marquis Westlake Development, Inc., 2020 WL 4783081 (Tex.App.-Dallas) (unpublished).

A Texas appeals court has rejected a buyer's claim that an escrowee had no right to interplead purchase money when a closing dispute arose, on its claim that the escrow instructions permitted interpleader of only the earnest money.

In 2014, Marquis Acquisitions, Inc. contracted to buy 86 acres of vacant land from Maguire Partners – Solana Land LP for $17 million. Silver Star Title agreed to serve as escrowee. Marquis assigned the purchase contract to five entities, controlled by several people. One of those men, Hickok, delivered the $250,000 earnest money. The buyers deposited the balance of the equity money of $6,000,000 with Silver Star. A lender deposited the loan proceeds of $11 million.

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The Friday before the Monday closing, Hickok and his partner Jeff Blackard had a fight about who would control the development. On Monday morning, the buyers' lawyer sent an email to Silver Star saying the buyers would not close, and demanding the return of the buyers' $6 million.

Silver Star's owner and president, Charles Brown, called the seller to inform it that the buyer was demanding the return of the money. Later that day, the seller sent Silver Star and Hickok a letter saying that it claimed all $17 million in escrow. By the end of the day, however, buyer and seller authorized Silver Star to return the $11 million in loan money to the bank, which it did.

Four days later, Silver Star filed an interpleader action, and deposited the closing documents and the buyer money with the district clerk. Not long afterward, the judge signed an agreed order disposing of the interpleader case. Silver Star complied with that order, delivering $250,000 to the seller and the rest to the buyers. Three weeks later, the buyer companies sued Silver Star for breach of fiduciary duty, breach of contract, conspiracy and aiding and abetting. The case went to a jury trial. The jury awarded the buyers about $400,000, based principally on its finding that the title company had no right to interplead the buyer's money other than the earnest money. The appeals court reversed.

The buyers' claims were founded in three seemingly contradictory escrow provisions of the purchase contract. Section 16.B of the contract said that, if the buyer demanded the return of the earnest money, the title company was to deliver that money to the buyer "despite any objection or potential objection by Seller." However, section 16.C of the contract said that, if either party terminated the contract, the other party could deliver a notice of objection to the escrowee. If it received such an objection, the title company was to hold the earnest money until it received "either written instructions executed by both Seller and Purchaser as to the disposition of the Earnest Money, or a court order, decree or judgment, which is not subject to appeal. . . ." Further confusing the matter was section 16.D, which said that, if there was "any controversy regarding the Earnest Money," the title company was entitled, at its option, to file an interpleader and "deposit the Earnest Money with a court of competent jurisdiction in which event the Title Company may recover all of its court costs and reasonable attorneys' fees."

The appeals court held that Silver Star did not breach the escrow instructions by interpleading the money. The court noted that the jury found that the title company was authorized to interplead the earnest money of $250,000. The question was whether or not the title company had the same rights in dealing with the balance of the purchase money. The court said that the contract was essentially silent about what the title company was to do with the balance of the purchase money, and therefore interpleader was not a breach of its instructions.

This decision reaches the correct conclusion, but is disjointed and not especially illuminating, in large part because it simply dissects a jury's special verdict answers. The fundamental deficiency in this set of escrow instructions was that it assumed the escrowee would never have to return any deposit other than the earnest money. The case is an important reminder to escrowees that they must read the escrow instructions embedded in a purchase contract to see if they make sense on the vital question of what to do if one of the parties refuses to close.

Interpleader is not always the appropriate response, and is not a prophylactic against liability. In *Mesirov Gelman Jaffe Cramer & Jamieson, LLP v. SVD Realty, LP*, 2001 WL 120142 (E.D.Pa.) (unpublished), the escrow instructions were reasonably clear that earnest money belonged to the buyer. The court held that an objection by the seller to the release of the funds (solicited by the escrowee) was an insufficient basis for interpleader of the funds. In *Land Title Co. v. Dubois*, 2000 WL 688253 (Tex. App.-Dallas) (unpublished), the court refused interpleader when there was an existing lawsuit about the sale of the property and the interpleader action filed by the escrowee (one of the parties' attorney) smelled to the court like forum-shopping. In *Wood v. Chicago Title Agency of Las Vegas, Inc.*, 109 Nev. 70, 847 P.2d 738 (1993), the escrowee obeyed a clear court order to deliver funds to Chapman. However, the escrowee had previously received notice that Chapman had assigned his interest in the money to Wood. The court entered summary judgment in favor of Wood for the escrowee's failure to honor the assignment. The court was unsympathetic to the fact that the escrowee paid the money based on the terms of the court's own order.

Agent Focus

Corporate Raiding by Ex-Employee is Debt Not Dischargeable in Bankruptcy

In re Smith, ___ B.R. ___, 2020 WL 4783895 (10th Cir. B.A.P. 2020) (permanent citation not yet available).

The debt owed by a former company manager and counsel to his ex-employer for having orchestrated the defection of many company employees to a newly formed agency is not dischargeable in bankruptcy, the Tenth Circuit has held.

As was reported in the December 2018 issue, Michael Smith was the chief operations officer and general counsel for Equity Title Insurance Agency Inc. in Utah. Smith had signed a non-compete agreement with Equity that barred him from recruiting Equity employees to a competing company. Between 2003 and 2009, First American Title bought the stock of Equity Title in several increments, eventually causing Equity Title to become a wholly owned subsidiary of First American.

In late 2014, Smith began taking steps to form a new title agency, called Northwest Title Insurance Agency LLC. On March 9, 2015, Northwest opened and Smith quit his job at First American Title. Within two weeks, more than 20 other First American employees joined Northwest Title.

First American Title sued Northwest, Smith and others for breach of the non-compete contracts, breach of fiduciary duty and other claims. The case went to trial in 2016. The jury awarded First American a money judgment of $1,625,000 in compensatory damages against Smith. The court awarded First American Title attorneys' fees of about $3 million. In the 2018 decision, the Tenth Circuit Court of Appeals affirmed the awards and judgment.

In 2017, Smith filed a chapter 7 bankruptcy petition. First American filed an adversary proceeding seeking to except the debt from discharge under Section 523(a)(6), for "willful and malicious injury by the debtor to another entity or to the property of another entity." The Utah bankruptcy court held that the debt was not dischargeable.

In this decision, the Tenth Circuit Bankruptcy Appellate Panel affirmed. The panel began by noting that the federal circuits disagree on whether "willful and malicious" injury is one standard or two separate elements, both of which must be proven, and that the Tenth Circuit position is less than clear. It said that it would treat the test as being two separate elements, although "whether the unitary or separate element approach is adopted should make no difference."

Willful injury is established by evidence of a specific intent to harm the creditor or proof that the debtor knew that such harm was substantially certain to occur. The standard is subjective. The bankruptcy court had held that Smith had acted with willful intent to harm First American by forming Northwest to compete with it and by hiring many of its key employees.

Smith's first argument on appeal was that he did not set out to hurt First American specifically, and that he only knew that the formation of Northwest would inflict general, "free market" harm to all competing businesses. He relied on an Eighth Circuit decision. The appeal panel said that a number of Tenth Circuit decisions have held that a debt is not dischargeable even when the debtor did not intend to cause specific harm. More importantly, it said, Smith's assertions were belied by the facts:

> *Smith was not just a market competitor—he was a former employee of First American that took twenty-seven long-term employees to start a competing business literally in the office building next door. Furthermore, the Equity employment agreement prohibited the solicitation of employees. This is more than just market competition. Smith fully understood the damage to First American's reputation and operation that would result from his actions. Smith's acts resulted in interference with contract, a legal injury—a violation of First American's legal rights, for which the law provides a remedy.*

Smith's second argument was that the bankruptcy court should not have used issue preclusion and the jury verdict to keep Smith from relitigating the issue of his subjective intent to harm First American. The appellate panel said that the issue of whether the prior verdict had preclusive effect was a question of Utah law, and that state law supports the doctrine of issue preclusion. The question was whether or not the type of subjective intent required under the bankruptcy code was the same level of intent required to enter a judgment for intentional interference with contract, the claim on which the jury verdict was based. The appellate panel said the two standards were close enough so that the verdict was a valid basis for issue preclusion and a finding of intent to harm.

Smith also argued that the court had not found the willful element because there was no proof that he intended to violate the non-compete and anti-hiring agreements that he had signed with Equity Title. He said he believed that contract was no longer in force after the First American buyout. The appellate panel recited a litany of evidence the bankruptcy court had relied on in making its findings. This included the fact that Smith had told another employee in 2011 that, if that employee left to join a title agency, Smith would enforce the non-compete provision. When the employee argued that the employment contract was unenforceable after the First American acquisition, "Smith responded it was absolutely enforceable." The appellate panel said that the evidence summarized by the bankruptcy court supported the finding that Smith caused willful injury to First American.

Smith also contested the malicious element of the test. The appellate panel said the bankruptcy court adopted the wrong standard in finding malice, but correctly found malice. The totality of the circumstances showed that Smith acted with malice, and that he had no legal justification or excuse.

Smith leaned heavily on a Tenth Circuit decision, *Pasek*, in which the court said that an accountant had not acted with malice by starting a new accounting firm in violation of his non-compete provision. This court said the facts in *Pasek* were different. In that case, the employee consulted a lawyer, who said the non-compete was not enforceable. He wanted to leave the firm because the working conditions were terrible. He took a few clients with him, but did not devastate the old firm. In this case, Smith did not consult a lawyer about the non-compete, and had reason to know it could be enforced. The court also noted that "emails sent by Smith suggested his intent to cause First American harm after leaving and that Smith even took satisfaction in First American's plight." Smith also "demonstrated no justification for the solicitation of First American's employees and customers." The court thus affirmed the ruling that Smith's debt is not dischargeable.

This dispute has been widely noted in the title industry, and is a sobering reminder to all.

Agent Focus

Loan Closer Owed No Duty to Borrower

Johnson v. U.S. Title Agency, Inc., 2020 -Ohio- 4056, 2020 WL 4719287 (Ohio App. 8 Dist.) (unpublished).

A title company engaged by a lender to close a loan was not the agent for the borrower, and was not liable for allegedly disobeying an oral instruction to give the borrower the "same" mechanic lien coverage under an owner's policy as the lender would receive in its loan policy.

This dispute was first reported in the July 2017 issue. Lawyer Richard G. Johnson hired and fired a

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contractor to remodel his house in Bentleyville, Ohio. Johnson then signed a contract with Berns Custom Homes to finish the job, and got a construction loan from KeyBank to pay for it.

KeyBank hired U.S. Title Agency Inc. to close the loan. KeyBank gave closing instructions to U.S. Title. The loan agreement contained a "consent" clause, under which Berns would have subordinated its lien rights to the mortgage. However, KeyBank did not make Berns sign the consent page.

Johnson hired lawyer Mark Wachter to negotiate the terms of the loan. Wachter ordered an owner's policy for Johnson. He claims he orally informed the U.S. Title closer that Johnson should receive the same mechanic lien protection on the owner policy as KeyBank would receive on the loan policy. The closer testified that he did not remember any such conversation with Wachter. Also, Wachter delivered no written closing instructions to U.S. Title.

U.S. Title issued a CPL for Johnson's benefit. However, the construction money was not deposited with U.S. Title, but was held by the lender to be disbursed as draw requests were submitted.

The loan policy was issued to the bank without a mechanic lien exception. The owner's policy contained a standard mechanic lien exception.

After the bank had disbursed two draws, Johnson fired Berns and refused to pay for work it performed after the last draw. Berns and several subs filed mechanic liens against the house. The lien disputes were arbitrated. The arbitrator found that Johnson had breached the contract by refusing to pay for work done, and by preventing Berns and the subcontractors from finishing the job. Berns got a judgment against Johnson for $166,550, which the Eighth Circuit Court of Appeals affirmed.

Later, Johnson hired a third contractor, Korner Construction, which finished the job. KeyBank disbursed the balance of the loan money.

Johnson demanded that Chicago Title pay to remove the mechanic liens. The insurer refused, based on Exclusion 3(a), Exclusion 3(d) for post-policy events, and the mechanic lien exception. As to his claim under the CPL, the insurer asserted the "created, suffered, assumed or agreed to" and the mechanic's liens exclusions in the letter.

Johnson sued U.S. Title and Chicago Title, making claims based on the policy, the CPL, for closing negligence and bad faith. In the 2017 decision, the appeals court reversed the trial court's order dismissing all claims, finding questions of fact.

The Cuyahoga County Court of Common Pleas held a nine-day jury trial in July 2018. The closer testified that it would have been impossible to delete the mechanic lien exception from the owner's policy, because the risk to a lender is lien priority, whereas the owner can cause a lien to be filed by refusing to pay for the work, and a title insurance policy does not "insure things that people cause on their own." U.S. Title and Chicago Title put on expert testimony from Michael Waiwood, who has worked in the title industry for almost 50 years. He testified that an owner cannot get mechanic lien coverage for work done after the policy date, saying:

> *[A]nything that occurs in an owner's policy subsequent to the date of policy is simply not covered. In addition to that, there [are] exclusions in the policy form itself. An exclusion to the title insurance policy by statute, by law in Ohio, is these are matters that are not covered by title policies. And one of the exclusions in the policy clearly states that it doesn't cover any matters after the date of the policy.*

Waiwood explained that, even if the mechanic lien exception had been deleted from Johnson's policy, Exclusions 3(a) and 3(d) would still have negated coverage. The court summarized his testimony this way:

> *He stated that "the policy does not cover any liens that become effective or filed after the date of policy." When asked whether the mechanic's lien exception would make a difference as to whether Berns's lien would be covered, he answered "absolutely not. They're not covered. It's that simple. We are not a casualty insurer. We could only insure up to the date of policy by law." … "And our position on that would be if I was being asked to underwrite this, I would say that these mechanic's liens are by virtue of the fact that Mr. Johnson simply did not pay his contractors."*

Waiwood also explained that the closing protection letter offered no mechanic lien coverage, because it protects only against the loss or theft of money delivered to closing.

Johnson called Robert Greggo as a rebuttal expert witness. He disputed some of what Waiwood had said.

The court granted U.S. Title's motion for directed verdict as to Johnson's negligence claim. The jury found for the title companies on the other claims.

In this decision, the appeals court affirmed the trial court ruling and jury verdict in all respects. Importantly, the court rejected Johnson's argument that its prior decision, at 2017-Ohio-2852, 91 N.E.3d 76, had made rulings that were the law of the case. Johnson claimed that the appeals court had already held that "an escrow agent owes a fiduciary duty to both parties," and other legal issues. The court said it had held in 2017 only that there were disputed questions of fact on those issues. The court admitted that it had found as a matter of law that Johnson was a third-party beneficiary of the loan closing instructions. However, the jury concluded that U.S. Title had not violated its written loan closing instructions, rendering that issue moot.

The appeals court then dealt with Johnson's claim that the court should not have directed a verdict in favor of U.S. Title on Johnson's claim that the title agent had been negligent in procuring insurance coverage as demanded by its customer. The court agreed with Johnson that such a claim is valid in Ohio, saying:

> *It is well settled that an insurance agency owes its customers a duty to exercise good faith and reasonable diligence in procuring its customer's insurance coverage. Slovak v. Adams, 141 Ohio App.3d 838, 845, 753 N.E.2d 910 (6th Dist.2001), citing Damon's Missouri, Inc. v. Davis,*

63 Ohio St.3d 605, 590 N.E.2d 254 (1992). We said as much in Johnson, 2017-Ohio-2852, 91 N.E.3d 76, ¶ 80.

The court said Johnson had presented evidence that he asked to have the exception removed, but the title companies had shown that the post-policy and "created, suffered, assumed" exclusions would still apply even if it had been. Thus, Johnson could not show that there was any coverage available for the mechanic lien risk.

Finally, the court upheld the trial court's directed verdict ruling that the closing protection letter did not give Johnson any mechanic lien coverage. It noted that "[e]ven Johnson's expert, Greggo, agreed that a claim under the closing protection coverage must be based on the failure to follow *written* closing instructions." The KeyBank closing instructions did not even tell U.S. Title to issue an owner's policy, much less one without a mechanic lien exception. Thus, "any alleged breach on the part of U.S. Title in procuring improper closing protection coverage could not have caused damages to Johnson for losses resulting from Berns's lien."

This decision provides excellent support for the orthodox principle that an owner's title insurance policy is not a payment bond protecting the owner against liens filed because of the owner's failure to pay the contractor. It also supports the fundamental principle that loan closing instructions about mechanic lien coverage are not an implicit instruction to give the owner the same coverage (which in fact is not the same coverage at all). The decision is a reminder that a title agent in Ohio and elsewhere can be sued for negligence in failing to procure the insurance coverage demanded by the insured. However, the court correctly put the burden on the owner to prove that he demanded such coverage, *and that the requested coverage was available*.

Sikora Law LLC represented Chicago Title and Alexander E. Goetsch of that firm defended the appeal. Meyers, Ronald P. Friedberg of Roman, Friedberg & Lewis represented U.S. Title Agency Inc.

Agent Focus

Neither Recorder Nor Closer Liable for Altered Deed

Olenchick v. Scramling, 2020 -Ohio- 4110, 2020 WL 4747487 (Ohio App. 11 Dist.) (not yet released for publication).

When a deed was altered to change the parking space conveyed with the condominium unit and then rerecorded, the recorder was not liable for accepting the rerecorded instrument, and the closer was not liable because it did not alter the deed.

John Scramling bought a residential unit at Bayridge Condominiums in Willowick, Ohio from Randy Olenchick in 2016. The purchase agreement described the property as a "1bdrm condominium, no garage space." When Randy Olenchick bought his residential unit in 1978, his deed also conveyed to him Garage Unit 41. Perhaps as a result, the deed drafted by an attorney for the sale to Scramling described the property as Randy's residential unit and "Garage Unit No. 41."

Later, someone changed the deed by crossing off "41" and writing "59" in its place, and by adding the handwritten note "deed rerecorded to show correct garage unit." The recording stamp was crossed off, and the deed was rerecorded with the Lake County Recorder.

Randy Olenchick's brother Rodney has parked cars in Garage Units 59 and 60 for decades, under an oral agreement with his brother. After the deed was rerecorded, Scramling demanded that Rodney stop using space 59, and he refused.

The Olenchick brothers sued Scramling, the Lake County Recorder and closer Ohio Real Title Agency LLC. They asked the court to order the recorder to correct the Scramling deed to excise the garage unit. The trial court ruled that Scramling did not own garage unit 59, and granted summary judgment to the recorder and Real Title. The appeals court affirmed.

The Olenchicks argued on appeal that someone in the recorder's office had altered the deed and rerecorded it, and that the recorder has no statutory authority to record a "fraudulent" deed. The appeals court agreed that the recorder's authority is limited to the recording of deeds and other instruments presented to the office for recording. Ohio law says that a recorder may refuse to record a deed presented for recording if it is not authorized for recording, or the recorder has reasonable cause to believe the deed is materially false or fraudulent. Revised Code section 317.13(B). However, that statute "does not create a duty upon a recorder to inspect, evaluate, or investigate an instrument of writing that is presented for recording."

The appeals court said the Olenchicks had provided no evidence that anyone in the recorder's office made the changes to the deed, or that it violated a duty under the law when it accepted and recorded the altered deed. Further, the alteration did not harm the Olenchicks, because that act was reversed by the court order.

The court also affirmed judgment in favor of Real Title. The trial court had ruled that Rodney had no standing to sue Real Title, because he did not own the garage unit and thus could not be harmed by the purported transfer of the parking space to Scramling. The appeals court said this reasoning was not very sound, since the record owner of the garage unit, Randy, did not dispute Rodney's claim of ownership. The appeals court also said the better argument about standing would have been that Rodney was not a party to the purchase contract or escrow instructions, but "neither party has briefed this issue." In any event, summary judgment was proper because the deed had been corrected, and Rodney had never lost his possession and use of the parking space and thus had no damage.

This decision is interesting because it is one of the very few to discuss the liability of a recorder in the acceptance of an altered deed. Many recorders are so worried about possible liability that they will not accept a deed containing any alteration.