



The News in General

Inside this issue:

- Can a Title Agent be Held Liable for Failing to Protect Borrowers from Themselves in Real Estate Transactions?* 1-2
- Title Company Pays for Assisting in Property Flipping* 2-3
- Equitable Subrogation Works for Non-Negligent Lender* 4
- Mortgage Invalidation Due to Wrong Borrower's Name Not Covered* 4-7
- Quick Hits From the Audit Trail...* 7-8
- Congratulations!!!* 9

Editors:

Carol Doering, Robert
Holman & Michael
McDonald

Contributing Editors:

Douglas Woods

The News In General

24262 Broadway Avenue
Oakwood Village, Ohio
44146

(440) 232-5511 Phone

(440) 232-1501 Fax

Email:

dwoods@generaltitleand
trust.com

"You Can Trust The General"

Can a Title Agent be Held Liable for Failing to Protect Borrowers from Themselves in Real Estate Transactions?

-Katherine E. Rudzik, Esq.

In *Childs v. Charske*,¹ the borrowers brought a suit for negligence against the title agents, mortgage brokers, and appraisers who provided services in multiple real estate transactions that all involved the Childs purchasing homes intending to "flip" them for a profit. The title agents claimed that they were hired to perform title and closing services, which they did, and therefore they were not liable to the borrowers for the losses suffered as a result of the transactions.

The borrowers claimed that the purchases were part of a "massive and complex multi-property and multi-player predatory lending scheme involving mortgage companies, appraisers, title companies, lenders and their respective employers, agents and principals."²

While the title agents denied having participated in any fraudulent activities related to the transactions, one would think that the buyer would be responsible for their own

losses since *they* decided to buy the multiple houses in a short period of time; that *they* would assume the risk of a bad investment and overextending themselves. However, the court felt differently:

Moreover, given the "particular circumstances" of real estate financing, which is confusing to the average person, and of the typical closing, with its multipart, preprinted forms, governmental regulatory requirements, arcane monetary calculations, and its simultaneously helter-skelter and perfunctory pro forma nature, all participants are "entitled to protection".³

How can the court make title agents responsible for protecting participants from themselves? The decision is one based on policy. The court assumes that title agents have more knowledge about the closing process than a borrower. Therefore, the court has shifted some of the risk of real estate transactions to title agents because it feels they are in a better position than the average borrower to foresee

future trouble and prevent its harm.

Whereas before it may have protected a title agent to not know the details of a transaction or question a transaction that it felt would end badly, the court in this case assumed that the title agents knew enough based on their involvement to know the buyers might be harmed. The court said the title agents could not escape liability by turning a blind eye.⁴

Under the theory of 'Willful Blindness', as the court refers to it, a title agent suspects the fraud, realizes its probability, but refrains from obtaining confirmation of it so that if asked later they could deny knowledge of it.⁵

What does this mean for title agents? It means that an agent can be liable to a borrower that he has never met for a transaction in which he performed his job properly and thoroughly. The liability does not arise from a mistake. The liability does not arise from actual knowledge. The courts have

Can a Title Agent be Held Liable for Failing to Protect Borrowers from Themselves in Real Estate Transactions? (continued from page 1)

The liability does not arise from actual knowledge. The courts have created a duty to protect and charged you with certain knowledge based on your experience.

That duty is not limitless or all encompassing. The court in *Childs* says the duty is relative to the involvement in the transaction.⁶ In other words, if the title agent only provides title insurance services, he will be held to a different standard of care than if he also provided closing services. The more involved the title agent is in the transaction, the more he must make sure that no one is

harmed by the transaction.

The liability under the theory of Willful Blindness is based on the title agent's duty to protect the others involved in the real estate transaction. It was designed to protect the inexperienced and innocent, but is not limited to them. In other words, enter each transaction like there is a duty to each party to protect them from harm. The duty is based on knowledge, if not of specific acts then the business in general. If the title agent believes that there is something wrong with a transaction, the best

policy is to walk away. If title agent's acts help complete the fraudulent transaction, even though he did not participate in the fraud or actually know about it, he could be liable to those involved.

¹ *Childs et al. v. Charske et al.*, 129 Ohio Misc.2d 50, 822 N.E.2d 853 (2004).

² *Id.* at 855.

³ *Id.* at 858.

⁴ *Id.* at 859.

⁵ *Id.* at 858.

⁶ *Id.* at 860.



Title Company Pays for Assisting in Property Flipping

The Title Insurance Law Newsletter (August 2006, p. 5)

American Title Co. of Houston v. Bomac Mortgage Holdings, LP., S.W.3d 2006 WL 2022396 (Tex.App.-Dallas).

When a title company failed to inform the lender of a simultaneous flip of the property, and concealed the flip by altering its title commitment to show the flipper in title, a court upheld a jury verdict for the loan amount plus a \$250,000 penalty under the Deceptive Trade Practices Act.

Bomac Mortgage Holdings lent \$288,000 to Anthony Norris to buy property in Galveston County, Texas. American Title

provided the title insurance and closing services. Lawrence Caldwell of First Interstate Financial Network, a mortgage broker, placed the order through Paulette Lee of American Title.

The property was owned by SDGA Investments when the file was opened. SDGA conveyed the property to the mortgage broker, First Interstate, for \$195,000, which sold it to Norris for \$320,000 the same day. The Bomac loan instructions required American Title to report a "simultaneous transaction" on the property. The title commitment "was altered to omit ownership information about

the property," the appeals court reported. A \$400 closing cost originally designated as an attorney "review fee" was used to pay Ms. Lee's personal rent.

Norris defaulted on the loan after Bomac sold it to Impac Funding Corporation. Bomac paid \$197,343.82 to Impac and sued American Title, alleging fraud and violations of the Texas DTPA.

The case was tried to a jury, which found that American Title had defrauded Bomac, committed theft, and acted unconscionably. The jury awarded Bomac the amount paid to Impac plus \$250,000 in additional damages under the



Title Company Pays for Assisting in Property Flipping (continued from page 2)

DTPA. American Title appealed, but the court affirmed.

One of American Title's arguments was that it did not owe Bomac the amount of the unpaid loan, because it had sold the loan to Impac. The court rejected that theory, holding that "[t]he unpaid amount of the loan is the direct damage from American Title's actions in violation of the DTPA: the loss 'conclusively presumed to have been foreseen or contemplated by the party as a consequence of his breach of contract or wrongful act.'

American Title also argued that there was insufficient evidence that it acted unconscionably, or was the cause of Bomac's damages. The court recited a litany of acts pinned directly to Lee which, it said, was more than mere neglect:

[T]he closing documents were altered so that the nature of the transaction was concealed; the HUD-1 form was changed and Lee's personal rent payment was made out of the loan proceeds; ... the closing documents erroneously showed Norris had made a downpayment; American Title did not follow Bomac's instructions to notify it of a simultaneous transaction; the proceeds of Bomac's

loan were used to facilitate two conveyances of the property; and both Lee and Caldwell participated in facilitating the two transactions so that it would not be apparent to Bomac that two sales took place on the same day with the proceeds of the loan to Norris. In short, there was ample evidence American Title, acting together with Caldwell, obtained Bomac's funds by concealing the true nature of the transaction.

American Title also argued that Bomac "simply knew too much to have been taken grossly unfair advantage of." For example, it should have realized that Caldwell was both the broker and the seller. The court found that Bomac's possible laxness did not excuse the active deceit of American Title's employee:

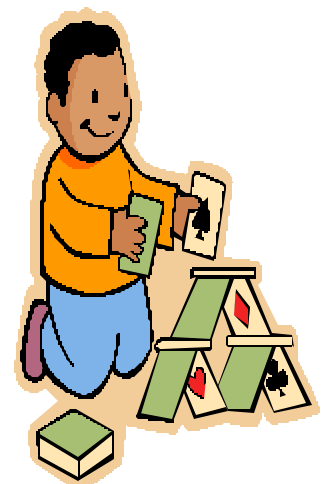
That Bomac, despite its experience, was not able to discover the altered title commitment, the re-directed closing payment, the type of transaction, and the source of the funds for the flip does not change the nature of American Title's conduct. There was evidence from which the jury could have determined it was unfair to Bomac to obtain its funds by concealing the nature of the transaction and that

"the resulting unfairness was glaringly noticeable, flagrant, complete and unmitigated."

Finally, the court upheld the finding that American Title had participated with Caldwell and Norris to fleece Bomac, despite the lack of proof that they actually conspired:

While it is true there was no direct evidence Lee, Caldwell, and Norris got together and agreed to take advantage of Bomac, Bomac introduced evidence Lee was fully aware of the nature of the transaction, assisted Caldwell with the documentation of the two sales, at least passed along, if not created, altered documents concealing the nature of the transaction, and accepted payment of her rent from the closing proceeds. From this evidence, a reasonable jury could have concluded two or more persons had specific intent to agree to accomplish an unlawful purpose or a lawful purpose by unlawful means.

Finally, the court upheld the finding that American Title had participated with Caldwell and Norris to fleece Bomac, despite the lack of proof that they actually conspired



Equitable Subrogation Works for Non-Negligent Lender

The Title Insurance Law Newsletter (August 2006, p. 9)

Federal Nat 'l Mortgage Ass'n v. Webb, 2006 WL 1901016, 2006-Ohio-3574 (Ohio App. 5 Dist.) (unpublished).

A lender was entitled to step into the shoes of a paid-off lender when there was no blatant search error and it got title insurance, per an Ohio court.

Evelyn McNickle owned property in Morrow County. She held title as Evelyn Knece, apparently a former married name. She got a mortgage loan from Fairbank Mortgage Bankers in 1998. The mortgage was re-recorded to list her name as "Evelyn M. McNickle, unmarried, ika Evelyn Knece."

A year later, Farm Credit Services of Mid-America got a large judgment against "M Evelyn McNickle" and two others. A few months later, McNickle recorded a deed from

Evelyn Knece as grantor to Evelyn McNickle, grantee.

Not long after, McNickle sold the property to Chad Webb, who got a mortgage loan from Washington Mutual Bank, FA. Fairbank Mortgage was paid off at closing. The court found that Washington Mutual intended to hold a first lien, and did not have actual knowledge of the Farm Credit judgment. The loan was assigned to Fannie Mae.

Webb defaulted, and the lender foreclosed. Farm Credit claimed to have the first lien. The trial court agreed, and Fannie Mae appealed.

The appeals court held that the judgment was in the chain of title because the re-recording of the mortgage gave notice in the records of McNickle's former name, creating a duty to search for judgments under that name. It also held that the initial "M" in the name did not foil effective notice of the judgment. Thus, Fannie Mae was not a bona fide encumbrancer without notice.

Fannie Mae fared better in its claim of equitable subrogation. The court emphasized that this doctrine "is used to prevent unjust enrichment." Under the seminal case of *Department of Taxation v. Jones*, 61 Ohio St.2d 99 (1980), the court said that the rule will be 'employed to help lenders who advance money "without discovering an intervening lien which a proper examination of the records would have disclosed."

In this case, the court found that "the certificate of judgment was clearly, discoverable in the line of title commencing in

1971," due to the mortgage re-recording.. Nonetheless, it granted equitable subrogation because Farm Credit would be in no worse position if Fannie Mae stood in Fairbank's shoes, and the lender itself had not been negligent:

Appellant [Fannie Mae] secured title insurance in order to protect *its* interests. None of the blatant negligent acts noted in the Jones case occurred sub judice. In particular, appellant was not the original mortgagee, but was subsequent to it. We therefore conclude the doctrine of equitable subrogation is applicable, but only to the extent of the 2003 payoff amount of the Fairbank mortgage, \$46,054.09. In so doing, appellee would not be placed in any different circumstances than at the time of the filing of the certificate of judgment

Michael Sikora, III, Michael Huff and Frank J. Rose, III represented Fannie Mae in this case.

Mortgage Invalidity Due to Wrong Borrower's Name Not Covered

The Title Insurance Law Newsletter (August 2006, p. 3)

First Merit Bank, NA v. Guarantee Title & Trust Co., 2006 WL 1791148 (Ohio App. 9 Dist.), 2006-Ohio-3333 (not yet released for publication).

In this case, the insured mortgage was not discovered by a later title searcher because

the wrong borrower's name was typed on the instrument, causing the loan not to be paid off at closing, and the borrower then filed bankruptcy. The insured lender made a claim on its title insurance policy, which the appeals court found excluded as a matter "created" by the insured.

Facts

A Mr. Webster purchased a home in Canton, Ohio with a mortgage loan from First Merit Bank. Guarantee Title & Trust

Company issued a title insurance policy to First Merit through its agent, ARTA of Stark County. The title insurance commitment, closing statement, and the deed prepared by ARTA's president all listed the buyer's name as "William S. Webster." The First Merit mortgage, however,

Mortgage Invalidity Due to Wrong Borrower's Name Not Covered (continued from page 4)

used the name "S. William Webster" (his real name is Samuel William Webster).

Webster sold the home a year later. The First Merit mortgage was not detected in a search under the name "William S. Webster." Webster did not step forward to notify the closer of the mortgage, and did not pay it off after closing. He filed for bankruptcy after First Merit sued him on the note and got a judgment.

First Merit sued Guarantee Title for its claimed loss. At a bench trial, the court found Guarantee Title negligent in preparing the deed and policy, and entered judgment for policy limits of \$56,000. The trial judge focused on the insuring provisions, particularly the indemnity against "invalidity or unenforceability of the lien of the insured mortgage upon the title." It reasoned that the mortgage was invalid and unenforceable as a result of the name issue, and held that "none of the exceptions to the policy are applicable to this loss." Guarantee Title appealed, and the court reversed.

Name Error Created by Insured

The appeals court

accepted Guarantee Title's main argument, that First Merit had "created" its own loss by drafting the mortgage using a name other than the one by which Webster took title, thus falling under Exclusion 3(a) for matters "created, suffered, assumed or agreed to" by the insured. It noted that Ohio law puts the onus on a lender to draft a mortgage so that it will impart constructive notice. The court cited *Baker v. Coffman*, 24 Ohio N.P. (N.S.) 259 (1922); *Brown v. Ault*, 56 Ohio LawAbs. 536 (N.D. Ohio 1949); *Waicker v. Banegura*, 357 Md. 450 (2000); and *Commonwealth v. Roberts* 392 Pa. 572 (1958) for the rule that "[i]t is the duty of a person offering an instrument for record to see that it is both properly recorded and properly indexed."

The court found that First Merit failed in its duty, and that its error fell under Exclusion 3(a):

First Merit sued Guarantee Title for its claimed loss. At a bench trial, the court found Guarantee Title negligent in preparing the deed and policy, and entered judgment for policy limits of \$56,000.

[First Merit] failed to reconcile the discrepancy between its mortgage and the deed. The deed filed with the Stark County Recorder's office shows that on June 19, 2000, title to the property was recorded under the name William S. Webster. [First Merit] asserts that title searches are generally conducted according to the title holder's last name and first initial, i.e. "Webster, W." ... Here, [First Merit] was clearly on notice that the property was titled under the name "William S. Webster" whereas it had issued the mortgage under the name "S. William Webster." ... [First Merit] could have verified that it had a valid lien on the property by perform-

ing a title search on the Stark County Recorder's Office website for the last name "Webster" and the first initial "S" or looking up the imaging number. Despite this notice, [First Merit] never attempted to verify the title and/or correct either the title or the mortgage documents.

First Merit sought to deflect blame to Webster for not taking title in his correct name, but the court found that this did not excuse the lender from matching the name in the mortgage to that in the deed:

[First Merit] claims that allowing Mr. Webster to take title in whatever name he wanted would serve to encourage the type of fraud that allegedly occurred in this case. We find this argument undermined by the fact

that Mr. Webster's legal name was actually Samuel William Webster, not S. William Webster. Therefore, we find that [First Merit] did not use Mr. Webster's legal name either and instead used his first initial and middle name. However, we need not weigh in on the proper means of taking title to property. The fact remains that [First Merit] could have avoided its loss by making certain that the name listed on the deed was exactly the same as the name it recorded on the mortgage. Even if [First Merit] failed to detect the difference prior to the date the deed was filed, [First Merit] could have later reconciled these documents if it had merely examined the deed.

Moreover, the title commitment ARTA prepared and faxed to [First Merit] on May 31, 2000 listed "William S. Webster" as the proposed insured. [First Merit] contends that it had no obligation to comply with the title commitment as it ceased to exist upon issuance of the Lender's Policy. However, Mr. May testified at trial that it would be important for [First Merit] to follow

Mortgage Invalidity Due to Wrong Borrower's Name Not Covered (continued from page 5)

the requirements of the title commitment in drafting the mortgage. Even if [First Merit] had no legal obligation to comply with the title commitment and even if the name listed in the title commitment was not proper, [First Merit] admittedly had notice of the requirements listed in the commitment and acknowledged its obligation to follow such requirements.

Upon review, we find that [First Merit] failed to meet its burden of demonstrating entitlement to coverage under the Lender's Policy. ... Further, [First Merit] had the duty to confirm the validity of his lien and failed to do so. Therefore, we find that [First Merit] "created, suffered, assumed or agreed to" a defect in the title when it failed to reconcile the names listed on the deed and mortgage.

In a later discussion of First Merit's negligence claim, the court provided an alternate basis for its ruling on the title insurance policy—that policy coverage was not triggered because there was no claim by someone else that title was defective as insured:

[First Merit] has not alleged that it suffered a loss as a result of a third party's claim against the title such as a claim that a prior mortgage was superior to its mortgage. Rather, [First Merit] asserted that it suffered damages as a result of the failure to detect its lien on the property. Because [First Merit] did not suffer a loss as a result of a third party claim, we find that the duty to indemnify was not triggered.

The court might have expanded on this brief ruling. The mortgage lien was never challenged. The lender's "loss" was due simply to the fact that it was not paid off at closing. Webster's later discharged of the loan debt in bankruptcy was not caused by the name error.

No Negligence

The court also reversed the finding that Guarantee Title had been negligent. The trial court had accepted the premise that Mr. Sparks of ARTA had a duty to draft the deed to match the name on the mortgage, not the other way around, and that Guarantee Title was "negligent" in issuing the loan policy despite the name mix-up.

The appeals court explained that a title insurance policy is an indemnity contract, as stated in paragraph 7 of the Conditions and Stipulations.

It relied on the holding in *Schwartz v. Stewart Title Guaranty Co.*, 134 Ohio App.3d 601 (1999) that rejected a negligence claim against a title insurer.

First Merit attempted to distinguish *Schwartz* because it concerned an owner's policy rather than a loan policy. The court rejected that position, holding that both forms of policy have the same terms on this issue. It also noted a second Ohio decision rejecting a form of negligence claim, this one having to do with a loan policy. *Chicago Title Ins. Co. v.*

Huntington Nat'l Bank, 87 Ohio St.3d 270 (1999). In that case, the claim was that the insurer was negligent in failing to detect a prior mortgage. The Supreme Court ruled that there could be no such tort liability, because paragraph 14 of the Conditions & Stipulations says the insured may only sue under the contract. That was good enough for the appeals court, which held:

We find that this policy language explicitly precludes an independent tort action by [First Merit] for negligence arising out of preparation of the deed. [First Merit] is limited to the contractual remedies provided for in the policy.



Therefore, we find that [First Merit] "created, suffered, assumed or agreed to" a defect in the title when it failed to reconcile the names listed on the deed and mortgage.



Mortgage Invalidity Due to Wrong Borrower's Name Not Covered (continued from page 6)

its negligence claim.

The well-reasoned First Merit decision may be unique in facing the issue of a loss claimed solely due to the lender's failure to get paid off on a subse-

quent sale because of its own failure to impart constructive notice.

Quick Hits From the Audit Trail...

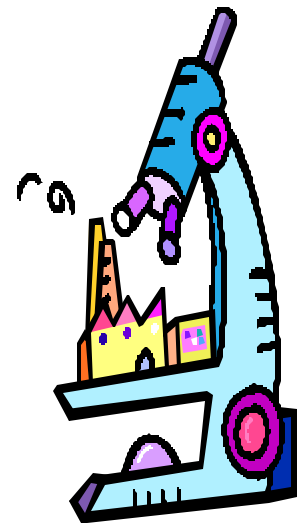
-Robert B. Holman, Esq.

The legal department has been conducting routine quality control audits of our agents and has noticed several consistent trends that should be addressed to all. One of the most important is the fact that search periods seem to be shrinking for Ohio agents. For instance, some agents are now accepting current owner searches on refinance transactions. **As a policy, the Company does not permit agents to issue insurance on current owner searches.** In fact, the minimum acceptable search period for a refinance transaction is a two-owner and/or ten-year search. If your agency is employing the use of current owner searches on transactions involving title insurance, please refrain from this practice immediately. The risk of missing a prior owner lien is too great! Our risk management philosophy will not permit lowering the thresholds below the aforementioned search period.

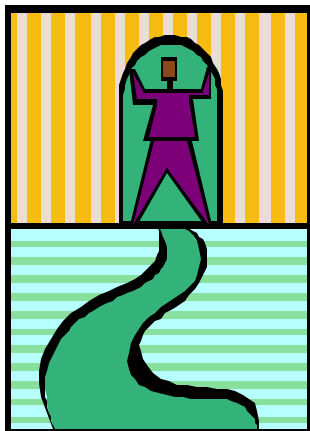
Another interesting trend seen in some of our quality control audits is the fact that the recording time between closing and recording is getting larger. For example, there are a few agents who have allowed mort-

gages and deeds to remain unfiled with the County Recorder's office for more than the five day maximum established as a matter of policy with the Company. Agents cannot allow mortgages and deeds to remain unfiled for any length of time. It is absolutely imperative that agents take all available steps to ensure that mortgages and deeds get filed no more than five days after closing. Why? If a mortgage is not recorded in the County Recorder's office within ten days after execution (in the example of a purchase transaction) or funding (in the example of a refinance transaction), the mortgage may not be deemed to be properly perfected under U.S. Bankruptcy law. If not properly perfected, a bankruptcy trustee may have the power to avoid the mortgage as a "voidable preference". Title insurance does not exclude a claim of the bankruptcy trustee that a mortgage was improperly perfected. Therefore, if the agent fails to properly file mortgages and deeds, it risks a lawsuit and a complete loss of title. Mortgages and deeds must be recorded within five days of execution.

As a final trend that has been spotted on our quality control audits, it is becoming clearer that title agents are allowing too much "wiggle" room for their outside title examiners when it comes to the subject of update title examinations. When requesting the performance of a title examination and then sending the executed documents to that examiner for the performance of an update title prior to recording, many title agents have no evidence to prove that: (a) the request to perform an update prior to recording was provided to the outside examiner; and (b) the evidence of the actual update was received by the agent. Title agents must become wise to the weakness. Agents should be requiring update examinations prior to recording any mortgage and/or deed. If your outside examiner is performing both the initial search and the recording, agents should document the retention of the examiner for both services and make sure that the act of requiring the update prior to recording is put **in writing**. All too often, the Company sees agents who permit verbal "okays" on up-



As a policy, the Company does not permit agents to issue insurance on current owner searches. In fact, the minimum acceptable search period for a refinance transaction is a two-owner and/or ten-year search.



Quick Hits From the Audit Trail... (continued from page 7)

date exams. The question becomes how can you prove that an update search was done three years from now? The answer is that the agent will not likely remember the “okay” in the future. Therefore, it is imperative that the agent docu-

ment this fact to allow the agent to pursue the abstractor’s errors and omissions carrier in the event of a claim. Experience is telling the Company that those who document have a much better chance of recov-

ering any potential losses due to the failure to properly update prior to recording.



July 2006

Sun	Mon	Tue	Wed	Thu	Fri	Sat
						1
2	3	4	5	6	7	8
9	10	11	12	13	14	15
16	17	18	19	20	21	22
23	24	25	26	27	28	29
30	31					

August 2006

Sun	Mon	Tue	Wed	Thu	Fri	Sat
		1	2	3	4	5
6	7	8	9	10	11	12
13	14	15	16	17	18	19
20	21	22	23	24	25	26
27	28	29	30	31		

We're on the web!
[Http://www.generaltileandtrust.com](http://www.generaltileandtrust.com)