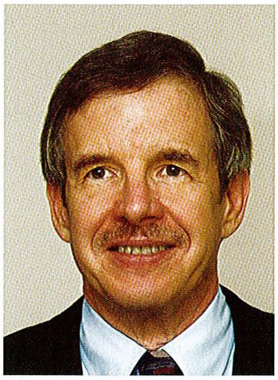
Top Ten Claims for 2009



— by —

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2009 was another busy year for the title insurance lawyers at Bean, Kinney & Korman, P.C. This article presents our top ten claims for the past year, based on our subjective judgment of their educational value. Some take away lessons for title agents: watch out for loan documents prepared by lenders, deeds prepared by attorneys and title policies prepared by other agents. We've changed the names in some cases and omitted them in others to avoid embarrassing anyone.

1. The almost right name.

Smith & Sons, Inc. applied to Friendly Bank for a mortgage loan to finance the company's business. The Bank ordered a title insurance commitment that showed title to the security property vested in Smith & Sons. The owner, it turned out, was a general partnership owned by members of the Smith family, who also owned the corporate borrower.

The Bank prepared a note and deed of trust for signature by an officer of Smith & Sons, Inc. The settlement agent obtained the required corporate signatures and recorded the deed of trust. After the loan went to default, the Bank discovered that the deed of trust was defective because the owner of the property never signed it.

No policy having been issued, the Bank sued the title insurer on a closing protection letter. The Bank alleged that the settlement agent failed to follow the Bank's instructions to provide the Bank with a first priority lien on the property. The title insurer is defending on the ground that the Bank caused the problem by putting the wrong name on the deed of trust, and then compounded the problem by issuing closing instructions that told the settlement agent it need not review documents prepared by the Bank. In 2010, a judge will tell us who must bear the loss.

2. You say Fatima; I say Fatina.

John deeded Blackacre to Kahled and Fatima. They took out a credit line deed of trust from Big Bank. The deed of trust named "Fatima" as the grantor, but she signed her name, "Fatina." The Clerk indexed the deed of trust under the name "Fatina."

When Kahled and Fatima sold Blackacre to Kelem, the abstractor missed Big Bank's deed of trust. After Big Bank foreclosed, Kelem sued to set aside the sale. He contended that the sale did not affect his title because Big Bank's deed of trust had been misindexed or misrecorded. A title insurance company hired our firm to defend Big Bank.

Kelem's misindexing claim was not a major concern. If the Clerk of the Court makes an error in indexing a mortgage, a subsequent purchaser takes the property subject to the mortgage, even if he does not know about it. *Jones v. Folks*, 149 Va. 140, 140 S.E. 126 (1927). The injured purchaser may be able to recover all or part of his loss by suing the Clerk for negligence. *First Virginia Bank-Colonial v. Baker*, 225 Va. 72, 301 S.E.2d 8 (1983).

Kelem's misrecording claim was based on his contention that the grantor named in the deed of trust did not own the property. "Fatima" was the record owner, but the grantor under the deed of trust signed her name "Fatina." We argued that the difference in the written expression of grantor's first name was not fatal. We invoked the doctrine of *idem sonens*, which holds that if two names sound alike, they are presumed to refer to the same person. *Goodman v. Riddick*, 152 Va. 693, 697, 148 S.E. 695, 696 (1929). Kelem responded that the *idem sonens* doctrine was an ancient rule that the court should disregard in the modern age. However, even if the *idem sonens* doctrine did not apply, we could have proved that the Fatima who owned the property was the same person as Fatina, who had signed the deed of trust. This would have established the validity of the deed of trust. *Id.* The case settled before trial.

3. Exhibit A is not an afterthought.

All of us know about Exhibit A, the document that (usually) gets attached to a deed or deed of trust to describe the property conveyed. One of the authors had his first encounter with a missing Exhibit A several years ago, when a borrower's bankruptcy trustee avoided a deed of trust that lacked a legal description. The settlement attorney claimed that the Clerk of the Court removed Exhibit A during the recordation process, which was probably the least convincing excuse since "the dog ate my homework." But that's a story from another year. This year we dealt with problematic Exhibits A.

Alli purchased Whiteacre in Maryland, but his settlement agent missed a deed of trust. A three-page document titled Deed of Trust had been recorded in the land records, together with nine separate pages, each titled "Exhibit A." Each Exhibit A described a separate property in the county. The three-page Deed of Trust was a printed form that had a space for describing the mortgaged property, but that space was left blank. Nothing in the three page document referred to an Exhibit A.

When the lender secured by the three-page deed of trust docketed a foreclosure proceeding, a title insurance company hired us to defend Alli. We asserted on his behalf that the three-page deed of trust was void because it contained no legal description of the property to be encumbered. *See Berlin v. Caplan*, 211 Md. 333, 127 A.2d 512 (1956). The trial judge aptly stated the issue: Did the nine pages recorded in the land records constitute a 12-page deed of trust, or a three-page deed of trust followed by nine concurrently recorded pages? The court took the matter under advisement.

4. The non-creditworthy spouse.

Even in the halcyon days of easy credit, some mortgage lenders still considered a borrower's credit report. Thus, when a married couple applied for stated income, subprime mortgage loan for 100% of the cost of buying a house, the lender balked because the husband had a bad credit rating. "Not to worry," said the creative mortgage broker. "We'll just fill out a loan application in the wife's name because her credit rating is ok." And so it came to pass that the loan was approved for the wife, and the couple purchased a house they couldn't afford.

The title insurance agent (a lay person) had an attorney prepare a deed. The attorney prepared the deed so that title would vest in the husband and wife as tenants by the entirety. (That's how it's always done, isn't it?) Meanwhile, the lender prepared a deed of trust for the wife's signature. You can see the train wreck coming, can't you?

After the borrowers defaulted on the loan, the lender found out it could not foreclose on tenancy by the entirety property. The deed of trust was worthless unless the husband predeceased the wife or the couple divorced. A title insurance company hired us to fix the lender's problem.

We opted for the most civilized of the potential solutions. We filed a suit to reform the deed of trust so that it would be effective against the husband and the wife. Our case was based on evidence that the parties actually intended for both spouses to sign the deed of trust, even though the wife would be the only party liable on the note. It helped that the husband had attended the closing and provided the settlement agent with a copy of his driver's license. The suit was unopposed, and the court granted the relief sought.

Our firm handled five cases more or less like this one in 2009. We wonder why it was always the husband who had the bad credit.

5. Exhibit A revisited.

Even if a deed of trust incorporates an attached Exhibit A, it may not be the right Exhibit A. In one such transaction, a subdivision developer acquired land for his subdivision by two different deeds. The developer subsequently applied for a development loan. The title insurance agent for the loan transaction prepared a title insurance commitment that described the proposed security property in an Exhibit A. However, this Exhibit A described only one of the two parcels that was to be included in the proposed subdivision. A loan officer for the bank prepared a deed of trust that described the mortgaged property in an attached Exhibit A, which was the same Exhibit A attached to the title insurance commitment. The title insurance agent recorded the deed of trust and issued a policy, with the same Exhibit A.

After a while, the developer filed a Chapter 11 bankruptcy. In an ensuing adversary proceeding, the Bankruptcy Court ruled that the deed of trust covered only the land described in Exhibit A. The Court also ruled that, once a bankruptcy had been filed, the deed of trust could not be reformed to encompass all of the land in the proposed subdivision, even if the parties intended for all of the land to be encumbered. As coverage counsel for the title insurance company, our firm wrote a letter denying the bank's claim because the bank had received good title to all of the land covered by the policy.

6. Exhibit A, again!

Coverage issues become more problematic when a title insurance agent issues a commitment for one parcel, but the lender's closing instructions require a lien on two parcels. In one such case the lender realized it had no claim under its title insurance policy. However, the lender asserted a claim under a closing protection letter, arguing that the title insurance agent had failed to follow the lender's written closing instructions to obtain title insurance for both parcels. We defended the title insurer in a suit before the U.S. District Court for the Eastern District of Virginia. One of our defenses was that the lender had prejudiced the title insurer by waiting until after the borrower had filed bankruptcy to report the claim. The case settled on terms favorable to the insurer.

7. What's a little horizontal privity between neighbors?

Mary's Trust owned Lot A, a waterfront property where she lived with her husband, Bill. Mary and Bill also owned adjacent Lot B. They decided to sell Lot A and live on Lot B.

Before selling Lot A, Mary, as trustee of her trust, recorded a restrictive covenant on Lot A that prohibited the building of a deep water pier. A stated purpose of the covenant was to protect Lot B's view of the water. However, the instrument containing the covenant did not identify a grantee.

The Trust then sold Lot A to Fred. Mary and Bill did not tell Fred about the covenant, and the title examiner did not report it. Fred's title insurance agent issued an owner's policy without exception for the covenant. Fred's title insurer hired us to fix the problem.

owner harvested timber on part of the 2000 acre site. Leviathan ordered a new title search. This disclosed that Leviathan held no record title to approximately 50 acres of its property. About half of the 50 acres was owned by the neighbor; the residue of the 50 acres was owned by heirs of an English settler who acquired the land in the 1700s and then went back to England.

We defended the title insurer in a suit by Leviathan under the policy and ultimately negotiated the settlement. Under the settlement, the insurer agreed to take further action to correct the title problem. The corrective action required an agreement to purchase the land owned by the neighbor and a quiet title action (based on adverse possession) against the heirs of the English settler. All ended well, except the insurance company had to pay several hundred thousand dollars to cover the cost of the neighbor's property. The insurer also had to pay the cost of the quiet title action and the company's own legal defense costs.

An underwriting counsel we consulted is of the opinion that at least three circumstances should have alerted Agency to do a full title search. First, Leviathan was already in title when it ordered the owner's policy. Second, the starter policy was a loan policy, which may have been subject to less stringent underwriting than an owner's policy. Third, the amounts of the proposed new policies were significantly greater than the amount of the prior loan policy.

10. Outta Site, Outta Mind.

In 1955, the US Army condemned land in Maryland for the purpose of building a NIKE missile site, along with a safety easement. The safety easement prohibited human habitation within an area of land surrounding the missile site. The missile site discontinued operations in 1962. Eventually, the Army sold the missile site to a third party, but forgot about the safety easement. Meanwhile, the owner of the land burdened by the easement sold the property to a joint venture, which later converted itself into a limited liability company.

The original joint venture/LLC members knew about the safety easement. They asked the Army to vacate the safety easement in the 1970s, but the Army's price for vacating the easement was too high. Eventually, they gave up and sold their membership interests to a second generation of owners. The second generation of owners sold their membership interests to a third generation of owners. The third generation of owners sold their membership interests to a fourth generation of owners. By this time, it seems that anyone who remembered the safety easement was no longer with the company. The fourth generation tried to sell the land to a developer, which discovered the safety easement through a title search.

These events gave rise to a claim under a title insurance policy issued to the owner when the fourth generation members acquired their limited liability company interests. The owner's policy took no exception for the safety easement. The title insurer hired us as its coverage counsel for the claim.

Settlement negotiations with the Army were unproductive. The Army valued the easement as if it were a fee simple interest in land.

The title insurer exercised its option under the policy to take legal action to remove the safety easement. In the ensuing quiet title suit, the owner claimed the Army abandoned the easement by selling the missile site to a commercial developer. The Army responded that the suit was barred by the Quiet Title Act, which provides that any suit against the United States to quiet title to land must be brought within 12 years of the date the owner learns about the government's interest in the property. The Army argued that the original joint venturers' knowledge of the safety easement must be imputed to the current owner because, in the eyes of the law, the current owner was the same entity as the joint venture.

Before the court reached any decision, the owner sold the land to Montgomery County, rendering the litigation moot. The County intends to train firefighters at the property, and we can't think of a better use for the former safety easement.

About the Authors

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Mr. Davis has co-chaired the D.C. Bar's Section on Real Estate, Housing and Land Use and has served as President of the District of Columbia Land Title Association. He graduated from the College of William and Mary and the University of Virginia School of Law. His academic honors include Phi Beta Kappa and Order of the Coif.

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