Title Insurer Not Liable for Approved Attorney's Misrepresentation, but Policy's "Unsuccessful Cure" Provision Did Not Apply

Guest Column
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The Evans brothers, Charles and Chris, bilked numerous banks in Mississippi and elsewhere for untold millions. In exchange for large sums of money, the Evanses executed promissory notes in the name of companies they controlled. The Evanses purported to secure the notes with deeds of trust on various properties. The Evanses obtained title insurance for their lenders based on applications submitted by Charles, who was an "approved attorney" for Mississippi Valley Title and Old Republic. Some of the applications stated that an Evans-controlled company owned land that was actually owned by someone else. Other applications failed to disclose mortgages. The title insurers issued commitments and policies based on the fraudulent applications. Charles served as settlement attorney for most of the loan closings.

Ultimately, the Evanses and their companies filed bankruptcy, which required the bankruptcy court to determine the ownership interests of multiple properties. In deciding cross motions for summary judgment filed by the title companies and the Evanses' mortgage lenders, the bankruptcy court made a number of rulings of interest to the title industry.

No Search Duty or Vicarious Liability

One of the Evanses' lenders was Bank of Forest ("BOF"). It filed cross claims against the title companies for fraudulent misrepresentation and negligent misrepresentation based on a title insurance commitment for a property known as Parcel T-3. BOF also sued the title companies for breach of contract based on a title insurance policy issued for properties known as Parcels T-4 and T-5.

The bankruptcy court prefaced its analysis of BOF's claims by observing that BOF and other banks victimized by the Evanses made incorrect assumptions about the nature of title insurance protection and about the role of an approved attorney. The banks "assumed that a title commitment was equivalent to a guaranty of good title" and that an approved attorney was an agent of the title companies. "Because of these two incorrect assumptions, the banks loaned money in a way that made them less vigilant against, and more vulnerable to, the misconduct of the Evans Brothers."

Fraud Claim on Title Commitment

BOF made a $451,450 loan to an Evans company to finance the purchase of Parcel T-3, but the bank's deed of trust was not a good lien because the borrower did not own the property. BOF sued the title companies for fraud, based on a title insurance commitment that stated title to Parcel T-3 was vested in a company called G&B Investments, Inc. The commitment failed to state that Parcel T-3 was actually owned by an Evans company known as Hanover and that Hanover had mortgaged Parcel T-3 to another bank. The information in the commitment was based on an application for title insurance submitted by Charles. BOF argued that the commitment's false statements regarding Parcel T-3's ownership were misrepresentations of a material fact that gave rise to a fraud claim against the title companies.

The bankruptcy court rejected BOF's fraud claim on several grounds. First, the court held that BOF had waived the fraud claim by failing promptly to repudiate the contract. Instead of repudiating the commitment for title insurance, BOF initially sought to enforce the commitment by tendering the required premium payment and demanding a policy. Further, BOF filed a pleading seeking specific performance of the commitment. By thus seeking to enforce the commitment, BOF waived any fraud claim.

In an alternative holding, the bankruptcy court ruled the fraud claim had no merit. The bankruptcy court first noted that the Mississippi courts had not ruled on whether a title insurance company has a duty to search for defects in title and report them before issuing a title commitment. After determining that authorities outside Mississippi were divided on the issue, the bankruptcy court decided against imposing an implied duty to search. "Recognizing an implied duty would result in a new tort cause of action in Mississippi that would arise independently from the contractual obligations in the title commitment and in this way would disrupt the agreement reached by the parties." The bankruptcy court agreed with the line of authorities holding that a commitment for title insurance "generally constitutes no more than a statement of the terms and conditions upon which the insurer is willing to issue a policy," citing *Greenberg v. Stewart Title Guar. Co.*, 492 N.W.2d 147, 151 (Wis. 1992).

The bankruptcy court went on to hold that BOF could not satisfy the elements of the tort of fraudulent misrepresentation, even if Mississippi law imposed an implied duty to search for title defects and report them. The court ruled that the commitment was not a false representation as to the status of the title to Parcel T-3 because the commitment's Condition 4 stated: "This Commitment is a contract to issue one or more title insurance policies and is not an abstract of title or a report on the condition of title."

The bankruptcy court ruled also that BOF failed to prove that the title companies acted with the intent to deceive BOF or with reckless disregard for the truth. The title compa-

nies had issued the commitment in reliance on the application submitted by Charles Evans and, in the bankruptcy court's opinion, relying on an application submitted by a licensed attorney was not reckless.

The bankruptcy court further ruled that BOF could not prove it had reasonably relied on the commitment as a representation of the status of the title because the commitment itself, in Condition 4, expressly stated the commitment was not a title abstract or report.

Having ruled that the commitment was not a representation of the status of the title, the bankruptcy court held that BOF had no cause of action against the title companies for negligent misrepresentation. Also, BOF had failed to prove the title companies were negligent. To establish negligence, BOF would have needed expert testimony that the standard of care for title insurers required them independently to confirm the accuracy of the information contained in an approved attorney's application. BOF provided no expert testimony that this was the standard of care.

BOF's Imputed Fraud Claim

The bankruptcy court next considered BOF's contention that the title companies were liable for Charles's frauds under principles of agency law. BOF argued that Charles was an implied agent or apparent agent of the title companies when he submitted the fraudulent application for the title insurance commitment. The bankruptcy court rejected BOF's implied agency theory because agency status requires proof of an agreement authorizing the agent to act on behalf of the principal, and BOF failed to adduce evidence of such an agreement. Further, Charles had never registered as an agent for a title insurance company, as required by Mississippi law. More important, in the bankruptcy court's view, was the testimony of BOF's loan officer that Charles Evans submitted the application for title insurance at BOF's request and performed other services for BOF.

The bankruptcy court rejected BOF's apparent agency theory because apparent agency must be based on a manifestation of the principal, and the title companies had done nothing that led BOF reasonably to believe that Charles was the title companies' agent. The title companies' only representations to BOF during the relevant time period were contained in two title commitments and one title policy. None of these documents held Evans out as the title companies' agent. The court ruled that Charles's status as an "approved attorney" was not indicative of agency status and, in any event, BOF's loan officer testified he "had no idea" concerning Charles's relationship with the title companies at the time of the closing.

No Further Duty When Title Cured

The title companies issued a policy insuring that BOF had a valid lien on Parcels T-4 and T-5. Although BOF's deed of trust was not a lien on these Parcels when the loan was made, the title companies succeeded in curing the problem, and considered the matter closed. Not so fast, said BOF. You owe us our legal fees for dealing with the problem, and also for the loss we sustained on the loan.

The bankruptcy court ruled that the title companies would need to pay BOF's legal defense costs in litigation with third parties to determine the status of title. This ruling was based on Mississippi's rule that an insurance company that reserves the right to deny coverage (as the insurance companies had done) must pay for independent counsel selected by the insured. Whether BOF really needed to hire two law firms, and whether their charges were reasonable, were factual questions that the bankruptcy court deferred for trial.

Although the title insurers had to pay BOF's legal defense costs, the bankruptcy court ruled that the title companies had no liability for BOF's loss on the loan. This ruling was based on policy Condition 9 (a), which specified that the title companies shall "not be liable for any loss or damage caused to the Insured" if the title companies cured the title defect in a reasonably diligent manner.

"Unsuccessful Cure" Clause Inapplicable

Another lender, Heritage Bank ("Heritage") made a $781,980.00 loan to one of the Evanses' companies on the security of a purported first deed of trust on Parcel T-6. The mortgage was worthless because the borrower did not own Parcel T-6. Heritage was unaware of the problem for 16 months because the Evanses made the required payments on the loan. After receiving notice of the problem, the title companies brought a state court action to enjoin the Evanses to convey Parcel T-6 to Heritage's borrower, but nothing came of that effort. Parcel T-6 had been conveyed to another Evans company, which had mortgaged the property.

Eight months after receiving Heritage's claim (approximately two years after the loan closing), the title companies tendered Heritage a $430,000 payment, based an appraised value of the property. The appraisal was dated approximately 18 months after the closing date. The title companies selected this date for valuing Heritage's loss because the date was the earliest date on which Heritage could have commenced a foreclosure sale. The title companies thought they had fulfilled their obligations by tendering the appraised value. Heritage disagreed.

The bankruptcy court ruled that the title companies had undervalued Heritage's claim. The title companies' hypothetical foreclosure date was "meaningless," in the bankruptcy court's opinion because Heritage never obtained a lien on Parcel T-6, and therefore could not have held an actual foreclosure sale. The bankruptcy court also expressed concern that "the real estate market had sustained an unprecedented decline" between the closing of the loan and the date of the title companies' valuation of the property. In these circumstances, the bankruptcy court ruled that a trial would be necessary to determine Heritage's damages. The bankruptcy court did not specify how the damages would be measured, but did appear to rule that the measurement would be made as of the date of the loan.

In the bankruptcy court's opinion, this result was not in-

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consistent with the policy. The policy at issue was a 2006 loan policy. Section 8 (b) of this policy contains what the Bankruptcy Court called an "unsuccessful cure" provision. This provision applies if the title company attempts to establish the title as insured, but does not succeed. In that event, the insured has the right to choose between one of two dates for evaluating the loss: the date of the insured's claim, or the date on which the claim is settled and paid. The bankruptcy court held that the unsuccessful cure provision was inapplicable because the state court action against the Evanses did not constitute an effort to cure the title defect and also because the title companies never gave Heritage the option of choosing the valuation date.

Absent the unsuccessful cure provision, the bankruptcy court ruled the policy ambiguous as to when and how the lender's loss was to be measured. Applying the rule that ambiguities are to be construed in favor of the insured, the bankruptcy court held that Heritage was entitled to have the loss valued at the date the loan closed. This interpretation, in the bankruptcy court's opinion, fulfilled Heritage's reasonable expectations. The bankruptcy court explained that "[a]llowing the insurer to wait to value the claim in a falling real estate market works to the insurer's benefit, a result that does not construe an ambiguity in the policy in favor of the insured," *citing* Barlow Burke, LAW OF TITLE INSURANCE (3d Ed. Aspen Publishers 2004).

Notwithstanding the underpayment of Heritage's claim, the bankruptcy court ruled that the title companies had not breached their implied covenant of good faith and fair dealing and had not committed the tort of bad faith.

The bankruptcy court's decision is reported at *G&B Invs., Inc. v. Henderson (In re Evans),* 2011 Bankr. LEXIS 3924, 2011 WL 4712176 (Bankr. S.D. Miss., Oct. 7, 2011).

Comments:

1. An article of this length cannot do full justice to the bankruptcy court's detailed examination of various nuances of agency law, including the adverse interest exception and the doctrine of dual agency. The opinion is worth careful study when a claimant alleges a title insurer is vicariously liable under agency law principles for an approved attorney's misconduct.

2. I question the bankruptcy court's ruling that the term "value" is ambiguous. Most courts find that an appraisal is an eminently acceptable method for valuing a loss arising from a title defect. However, the bankruptcy court was correct in holding that, apart from the "unsuccessful cure" provision, the 2006 ALTA loan policy does not specify the date for determining the lender's loss. The title companies invoked the usual rule that a loss under a loan policy is measured as of the date of the foreclosure sale, but the bankruptcy court held the usual rule inapplicable because Heritage could not foreclose.

3. As noted in the case summary, the bankruptcy court ruled that the title companies' injunction suit against the Evanses and their companies was not an effort to cure the title defect. This ruling is questionable because bringing legal action on behalf of the insured is a normal and customary means by which title insurers cure title defects. Section 9 (a) of the policy states that the methods by which a title company may remedy defects include "litigation and the completion of any appeals."

Reasonable Expectations Doctrine Does Not Apply to Sophisticated Insured

Dare Investments, LLC v. Chicago Title Ins. Co., 2011 WL 5513196 (D.N.J.) (permanent citation not yet available).

A commercial entity that bought a complicated loan, represented by two law firms, and which sought an exotic endorsement, was a sophisticated policyholder who may not claim the benefit of the reasonable expectations doctrine.

In a case first reported in the August issue, Dare Investments bought a loan secured by a $15 million mortgage which the borrower later claimed had been paid in full. The facts and the loan documents are complicated. Dare has a Chicago Title policy.

In the earlier decision, the court dismissed all claims brought by Dare against Chicago Title except the contract claim on the policy. Dare moved for reconsideration. The court did not revive any of Dare's claims, but it did hold that Dare is not entitled to the reasonable expectations doctrine. That rule is used by courts to interpret a policy against the insurer as drafter "because of the vast differences in the bargaining positions between an insured and an insurance company in the drafting of an insurance policy… ." The rule does not apply, however, when the insured is a sophisticated commercial entity "that do[es] not suffer from the same inadequacies as the ordinary unschooled policyholder and that ha[s] participated in the drafting of the insurance contract." Chicago Title cited *McNeilab, Inc. v. North River Ins. Co.*, 645 F.Supp. 525 (D.N.J.1986), *Chubb Custom Ins. Co. v. Prudential Ins. Co. of Am.*, 195 N.J. 231, 948 A.2d 1285 (2008), *Werner Indus. Inc. v. First State Ins. Co.*, 112 N.J. 30, 548 A.2d 188 (1988), and *President v. Jenkins*, 180 N.J. 550, 853 A.2d 247 (2004).

The court found that Dare was a sophisticated entity, because it "hired two well known law firms to conduct due diligence on the validity and enforceability of the Sayreville Mortgage and negotiate the terms of the title policy covering that mortgage." Further, the lawyers did negotiate policy coverage, including two unusual provisions that are the heart of the coverage dispute. The court ruled that the doctrine either applies to the insured or does not, and rejected Dare's suggestion that the court construe against Chicago Title every term of the policy not specifically negotiated (such as

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