Court Dismisses Foreclosure Rescue Suit Against Title Insurers

By James Bruce Dave, Esquire

In a putative class action by victims of a foreclosure rescue scam, the United States District Court for the District of Maryland granted motions to dismiss by Chicago Title Insurance Company and Southern Title Insurance Company. The Court ruled the settlement agents that closed the foreclosure rescue transactions were not the title insurers' agents for the purpose of conducting closings. This outcome will come as no surprise to readers familiar with closing protection letter litigation. Nevertheless, the opinion is noteworthy for the Court's disposition of the claims at the pleading stage and for its well reasoned examination of the scope of a title insurance agent's authority.

The plaintiffs, Melvin and Nadine Proctor, sued a mortgage broker, the Metropolitan Money Store, claiming it cheated them in a foreclosure rescue transaction. The transaction's structure was typical of foreclosure rescues: a sale of the Proctor's home to a "straw" buyer, a one-year lease back to the Proctors, and an unaffordable repurchase option. Policy issuing agents for Chicago Title and Southern closed the transactions for the Proctors and other putative class members. The Proctors alleged these agents enabled Metropolitan to defraud distressed homeowners, and claimed that the title insurers were vicariously liable for the agents' misconduct under the doctrine of *respondeat superior*. The Proctors advanced an alternative theory of recovery based on the insurers' alleged negligent supervision of the agents.

A motion to dismiss tests the sufficiency of the complaint. From 1957 to 2007, a federal court could not dismiss a complaint for failure to state a claim unless the court concluded beyond doubt the plaintiff could prove no set of facts that would entitle him to relief. Conly v. Gibson,

355 U.S. 41, 45-46 (1957). Under Conly, the Proctor's complaint might have survived a motion to dismiss. However, in Bell Atlantic Corp. v. Twombly, ___ U.S. ___, 127 S. Ct. 1955 (2007), the Supreme Court retired Conly's rule and replaced it with a new test: to survive a motion to dismiss, the complaint must allege "enough facts to state a claim to relief that is plausible on its face." Bell Atlantic, 127 S. Ct. at 1974. The Proctors' complaint failed to satisfy the Bell Atlantic standard.

In moving to dismiss, the title insurers relied on their agency contracts, to which the Proctors' complaint had made reference. The agency contracts appointed the settlement agents the insurers' agents only for the purpose of issuing title insurance policies and commitments. Chicago Title's agency agreement stated explicitly that Chicago Title's agent "is not an agent for purposes of conducting a closing." Southern's agency contract did not have the same disclaimer, but was of similar import.

Although the Proctor court found the express disclaimer of an agency relationship "highly relevant to the inquiry," the disclaimer was not dispositive because the parties' conduct may be used to prove an agent's authority goes beyond the authority expressed in a written agency contract. If this were not so, "parties could simply disclaim an agency relationship generally to avoid liability to third parties while agreeing to specific provisions that in fact bind each other to an arrangement that is the equivalent of principal and agent." Having ruled that the contract was not dispositive, the Court proceeded to examine the Proctors' factual allegations regarding the insurers' and agents' conduct.

The Proctors relied on three kinds of allegations to support their claim that the agents conducted the closings for the insurers. First, the insurers issued agency bulletins from time to time informing the agents of potential risks that might result in policy losses. Second, the agency contracts required the agents to use proper escrow accounting procedures and gave the insurers the right to audit the agents' accounts. Third, the insurers issued closing protection letters indemnifying lender against improper settlement activities by the agents.

The Court ruled that the insurers' issuance of closing protection letters was not evidence of an agency relationship. The practice of issuing closing protection letters "cuts the other way, demonstrating the need for additional protection because of the absence of agency liability." If the title insurers had *respondeat superior* liability for the agents' misconduct, lenders would have no need of closing protection letters.

The Proctor court was unsatisfied that the contract terms on which the plaintiff's relied altered the otherwise limited agency relationships. The issue was whether the agency contracts gave the insurers control over how the agents conducted closings. The Court held that contractual terms requiring the agents to use escrow funds for their intended purposes did not evidence control, but merely restated legal duties to which the agents were already subject. Additionally, general requirements concerning the structure of escrow accounts, reconciliations, audits and indemnification, although indicia of some level of insurer control, were geared primarily toward minimizing the risk of loss under policies, closing protection letters and allegations of vicarious liability.

The Proctor court ruled also that sharing industry information and best practice tips did not tend to establish agency, but instead reflected the insurers' and agent's shared interest in minimizing title risks. The Court concluded, "the title agents here retained a tremendous amount of discretion on a day-to-day basis in the provision of settlement and closing services and were not acting primarily for the benefit of the title insurers in those activities." The general operating requirements set forth in the agency contracts did not give the insurers sufficient control to bring closings within the scope of the agents' duties to the insurers.

The Court also rejected the Proctors' contention that a Maryland statute altered the principal-agent relationship. The statute requires title insurers annually to review their agents' operations. However, the statute disclaims intent to supersede contractual relations between insurer and agent, and the statute does not require "the type of detailed oversight and responsibility inherent in a common law agency relationship."

The Proctor court ruled also that the Proctors failed to state a claim based on the doctrine of ratification. The Proctors alleged the insurers ratified the agents' actions by accepting premium remittances. This allegation failed to state a claim for ratification because the Proctors failed to allege the insurers knew about the fraud when they accepted the premiums.

Finally, the Court rejected the Proctors' negligent supervision claim. First, the Court ruled Maryland's statutory provisions for oversight of title insurance agents did not create a private right of action. Second, the Court ruled the insurers had no common law duty to supervise the

agents' closing activities because the agents were not the insurers' agents for the purpose of conducting closings. Third, the Court held the Proctors' negligent supervision claim deficient because the Proctors alleged no specific act of negligence; instead, they made only a conclusory allegation that the insurers were grossly negligent.

The cite for the opinion is Proctor v. Metropolitan Money Store, 2008 U.S. Dist LEXIS 77823 (D.Md).

Comments:

1. Under Conly, some courts were reluctant to dismiss *respondeat superior* claims at the pleading stage because the existence of an agency relationship is a question of fact. E.g., American Home Mortgage Corp. v. First American Title Insurance Company, 2007 U.S. Dist. LEXIS 83337 (D.N.J. 2007). Bell Atlantic sent Conly into retirement, so title insurers should have an easier time disposing of a case like Proctor through a motion to dismiss.
2. Proctor holds that a title insurer's issuance of a closing protection letter cuts against a finding that a title insurance agent is the insurer's agent for the purpose of conducting closings. This holding is sound because the closing protection letter would serve no purpose if the title insurer was already liable for a settlement agent's misconduct under the *respondeat superior* doctrine.
3. Bergin Financial, Inc., v. First American Title Company, 2008 U.S. Dist. LEXIS 6196 (E.D. Mich.), held that a policy issuing agent was not the underwriter's agent for the purpose of conducting closings where the insurer had not issued a closing protection

letter. The Court decided the issue on the insurer's motion for summary judgment.

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