THE LAW OF CLOSING PROTECTION LETTERS

James Bruce Davis

Mortgage lenders often entrust large sums of money to settlement agents-attorneys, escrow companies or title insurance agents-without knowing anything about an agent's competence or honesty. This seemingly risky practice is enabled by closing protection letters. A closing protection letter is an agreement by a title insurance company to indemnify a lender, or in some cases a purchaser, for loss caused by a settlement agent's fraud or dishonesty or by the agent's failure to follow the lender's written closing instructions.[1]

Closing protection letters originated when title insurance companies approached customers, especially national lenders, about ordering title insurance through a company's issuing agents or approved attorneys.[2] To address a customer's natural concern about entrusting money or documents to unfamiliar settlement agents, title insurers began to offer "insured closing service" letters obligating a title insurer to stand behind a settlement agent agent's work.[3] One court described an insured closing letter as "a

---

1. See, e.g., AMERICAN TITLE INSURANCE ASSOCIATION, POLICY FORMS HANDBOOK § VI-2 (Closing Protection Letter & Explanation), at 1-2 of 4 (rev. March 27, 1987), the standard closing protection letter form promulgated by the American Land Title Association [hereinafter ALTA Closing Protection Letter]. *See generally* BARLOW BURKE, LAW OF TITLE INSURANCE § 13.10 at 13-102 (3d ed. 2000).

2. ALTA Closing Protection Letter, at 3 of 4.

3. *See, e.g.,* Lawyers Title Ins. Corp. v. Edmar Constr. Co., 294 A.2d 865, 866 (D.C. 1972), which described the origin of closing protection letters:

> As part of its business practice Lawyers Title had developed a list of "approved attorneys." When a title search was performed by an attorney appearing on this list, Lawyers Title would forego an independent title search in issuing title insurance and instead would rely on the search made by the "approved attorney." In addition, Lawyers Title had circulated an advertising letter to lenders throughout this area assuring them they would not suffer loss due to work done by "approved attorneys."

Id. at 866.

James Bruce Davis is a member of the firm of Bean, Kinney & Korman, PC in Arlington, Virginia.

business gesture to indemnify the lender if a defalcation by an approved attorney occurred.[4]

Insured closing service letters took many forms, and the lack of uniformity became a concern to title insurance customers.[5] One national lender received "closing indemnities differing in protection not only from insurer to insurer, but from state to state or from time to time as issued by the same insurer."[6] A title industry trade association, the American Land Title Association,[7] responded to these concerns by developing a standard form that ALTA calls "a carefully drafted statement, that, on due consideration, might be acceptable to insurer and insured." ALTA's current form of closing indemnity, called a "closing protection letter," was last revised on March 27, 1987.[9] Three variations of the form were adopted on October 17, 1988.[10]

In most states, closing protection letters have become a standard feature of mortgage loan closings conducted by anyone other than a title insurance company. Generally, national lenders will not entrust money or loan documents to settlement attorneys or title insurance agents unless the title insurer has issued a closing protection letter, addressed to the lender, covering closings by the settlement agent.[11] Similarly, regulations for various governmental loan programs require settlement agents to provide either a closing protection letter or a fidelity bond to protect the funding agency.[12] The practice is different in states where closing, protection letters are prohibited by law, as in New York, where lenders protect themselves against the risk of misappropriation by a settlement agent by having their own attorneys disburse the loan proceeds.[13]

Despite the importance of closing protection letters in mortgage lending

---

4. *Id.* at 868.
5. ALTA Closing Protection Letter, at 3 of 4.
6. *Id.*
7. Hereinafter ALTA.
8. ALTA Closing Protection Letter, at 3 of 4.
9. *Id.*, at I of 4.
10. AMERICAN TITLE INSURANCE ASSOCIATION, POLICY FORMS HANDBOOK §§ 2(b), and VI-2(c) (Oct. 17, 1998). The variations are titled "Regulatory," "Nonresidential Limitations," and "Single Transaction Limited Liability."
11. Mortgage lenders typically issue underwriting guidelines for themselves and their correspondents that require a closing protection letter as a condition precedent to advancing loan funds to a settlement agent other than a title insurance company. See, e.g., PNC MORTGAGE SECURITIES CORP., CORRESPONDENT TABLE FUNDING GUIDELINES, at http://www.pncmsc.com/TFPKT.html (last visited Nov. 28, 2000) [hereinafter PNC GUIDELINES]; SOVEREIGN BANK WHOLESALE LENDING GUIDE, ' 6A, at http://sovereignwholesale.com/ guides/guide_8.html (last visited Nov. 29, 2000).
12. E.g., Rural Housing Service and Farm Service Agency, Real Estate Title Clearance and Loan Closing Regulations, 7 C.F.R. " 1927.52, 1927.54 (2000).
13. See PNC GUIDELINES, *supra* note 11 (describing "attorney closings" in New York, and establishing "eligibility criteria" for attorneys to which the lender will advance loan proceeds for "table funding").

and real estate transactions, relatively few court decisions illuminate the meaning of closing protection letters, and significant questions remain unanswered regarding the scope of a title insurer's liability, the measure of damages, and the rights of third parties to rely on closing protection letters. This article explores those questions, together with such related topics as the risk of loss in the absence of a closing protection letter, the nature of the title insurer's obligation under a closing protection letter, and whether a closing protection letter constitutes insurance. This article also considers the scope of a title insurer's right to recover from third parties for losses paid under a closing protection letter.

I. THE RISK OF LOSS IN THE ABSENCE OF A CLOSING PROTECTION LETTER

A substantial majority of courts hold that if a title insurance company has not issued a closing protection letter, the title insurer has no liability for fraud or other misconduct by a settlement agent in connection with a real estate closing.[14] Unless a lender's loss is covered by some provision of a title insurance policy, or unless a statute provides otherwise,[15] the lender rather than the title insurer bears the risk of a loss caused by a settlement agent's misconduct.

Courts have considered the matter principally as a question of agency law, that is, whether the settlement agent had actual or apparent authority to conduct closings on behalf of the title insurance company. Actual authority "usually denotes that authority which a principal a) intentionally confers upon an agent, b) intentionally allows the agent to believe that he possesses, or c) by want of due care allows the agent to believe that he possesses."[16] Apparent authority arises when a principal acts in a way that

14. Resolution Trust Corp. v. Am. Title Ins. Co., 901 F. Supp. 1122 (M.D. La. 1995); Universal Bank v. Lawyers Title Ins. Corp., 73 Cal. Rptr. 2d 196 (Cal. Ct. App. 1997); Security Union Title Ins. Co. v. Citibank, 715 So. 2d 973 (Fl. Dist. Ct. App. 1998), Spring Garden 79U, Inc. v. Stewart Title Co., 874 S.W.2d 945 (Tex. App. 1994) (issuing agent); Cameron County Sav. Assoc. v. Stewart Title Guar. Co., 819 S.W.2d 600 (Tex. App. 1991) (issuing agent); Southwest Title Ins. Co. v. Northland Bldg. Corp., 552 S.W.2d 425 (Tex. 1977) (approved attorney); *contra*, *Sears* Mortgage Corp. v. Rose, 634 A.2d 74 (NJ. 1993); Meyerson v. Lawyers Title Ins. Corp., 3 3 3 N.Y.S.2d 3 3 (N.Y. App. Div. 197 3), *aff'd,* 3 04 N.E.2d 3 71 (N.Y. *1* 9 7 3) (approved attorney). Bodell Constr. Co. v. Stewart Title Guar. Co., 94 5 P.2 d 119 (Utah App. 1997). *Meyerson* may be inconsistent with *Mandor v. Lawyers Title Ins. Corp.,* 269 N.E.2 d 82 8 (N.Y 197 1), which held that the title insurance company would have no liability for the actions of its agent unless a policy was issued. *See Meyerson,* 333 N.Y.S.2d at 38-39 (Steuer, J., dissenting).

15. Eg., FLA. STAT. ANN. § 627.792 (West Supp. 2000) (providing that a title insurer is liable for defalcation, conversion, or misappropriation of settlement funds held in escrow by a licensed title insurance agent).

16. Cameron County Sav. Assoc., 819 S.W.2d at 602-03.

leads another to reasonably believe that a third party has authority to act for the principal.[17]

A settlement agent's actual authority to act on behalf of a title insurer derives from the agent's issuing agency agreement or approved attorney agreement with the title insurance company. Issuing agency contracts between title insurers and their agents normally limit an issuing agent's authority to issuing title insurance commitments and policies and provide, specifically, that any settlement or closing business conducted by the agent will be for the agent's own account, not on behalf of the title insurance company.[18] When an agency contract expressly prohibits an agent from conducting closings on behalf of a title insurance company, the agent can have no implied authority to conduct such closings.[19] An approved attorney's authority is even less than that of an issuing agent because an approved attorney is not authorized to issue binders, commitments, or policies on behalf of the title insurance company.[20] Based on the contract between the title insurer and its issuing agent or approved attorney, courts typically hold that closings fall outside the scope of a settlement agent's express or implied actual authority to act on behalf of the insurance company.

Courts usually resolve the question of apparent authority in favor of the title insurance company because the defrauded plaintiff usually is unable to produce any communication whereby the title insurer led the plaintiff to believe that the settlement agent would be acting for the title insurer in conducting closings.[21] An agent's apparent authority flows only from the principal's conduct toward third parties, and a person dealing with an agent is "under an obligation to ascertain the scope of that agency."[22] Most courts

17. *Id.*

18. For example, the agency contract at issue in *Bodell* provided: "Although COMPANY [the agent] may conduct an escrow business, COMPANY shall not represent to the public that it is an agent of underwriter (the title insurer] in the conduct of the escrow business." *Boded, 945* P.2d at 122. The agency agreement in *Universal Bank specifically* excluded from the scope of the agency subescrow activities, including "closing of real estate transactions." *Universal Bank,* 73 Cal. Rptr. 2d at 198. The agency agreement in *Am. Title Ins.* Co. contained a promise by the agent "not to receive nor receipt for any funds, including escrow funds, in the name of [the title insurance company], but shall receive and receipt for funds, including escrow funds, for its own account." *Am. Title Ins. Co.*. 901 F. Supp. at 1124. Similar language appeared in the agency agreement involved in *Cameron County Sav. Assoc*., 819 S.W.2d at 603.

19. Cameron County Sav. Assoc., 819 S.W.2d at 603.

20. An "approved attorney" is an attorney upon whose certificates of title the title insurance company issues title insurance policies. ALTA, Closing Protection Letter, at 1 of 4.

21. Id. See Security Union Title Ins. Co. v. Citibank, 715 So. 2d 973, *975* (Fla. Dist. Ct. *App. 1998)* ("Apparent authority rests on the doctrine of estoppel and arises from the fact of representations or actions by the principal and a change of position by a third party who in good faith relies on such representations or actions.... [T]he determination of whether an agent acts within apparent authority requires ... that the principal create the appearance of' apparent authority.").

22. *Bodell, 945* P.2d at 124.

hold that a title insurer may furnish an agent stamps or documents for use in issuing title insurance policies without cloaking the agent with actual or apparent authority to act for the title insurance company in conducting settlements. Furthermore, acquiescence in the agent's use of the title insurer's name on the agent's letterhead would not cloak the agent with actual or apparent authority to conduct closings on behalf of the title insurer.[23] Such actions are consistent with the agent's authority to issue commitments and policies on behalf of the title insurance company, and do not communicate the title insurer's intention to include closings within the scope of an issuing agent's authority. Courts taking this view have stated that settlement agents may wear "two hats," one as an agent of a title insurance company to issue commitments and policies and the other as a settlement agent to conduct closings.[24] Although the agent's acts bind the title insurance company when he or she wears the first hat, the agent's actions do not bind the title insurer when the agent wears the second hat. Perhaps reflecting lenders' widespread practice of using closing protection letters, one court cited the lack of any "guaranteed closing letter" as evidence that the title insurance company would have no liability for a settlement agent's failure to disclose irregular or fraudulent acts to a lender for which the agent performed a closing.[25]

The one strong voice in opposition to the majority view comes from the New Jersey Supreme Court.[26] In *Sears Mortgage Corp. v. Rose,* the court held a title insurance company liable to a purchaser for an approved attorney's defalcation, even in the absence of a closing protection letter. The court held that where a title insurance company followed the "north Jersey" practice of dealing with customers only through the title insurance company's approved attorneys, the title insurer was liable to a purchaser for an

23. Id.; Security Union Title Ins. Co., -1 15 So. *2* d at 97 5 (Title insurer made no representations that agent had authority to act as agent for title insurer "except within the confines of his actual authority to act as [the title insurance company's] title insurance issuing agent."). *But see* Meyerson v. Lawyers Title Ins. Corp., 3 3 3 N.Y.S.2d 3 3, 3 5 (N.Y. App. Div. 1973) (where title insurance company furnished approved attorney with for-ins, bearing the company's name, for use in preparing title reports, the title insurance company was liable to a purchaser for losses caused by the approved attorney's fraudulent title report).

24. *Cameron* County Sav. Assoc., 819 S.W.2d at 604; *Security Union Title Ins. Co.,* 715 So. 2d at 975.

25. Resolution Trust Co. v. Am. Title Ins. Co., 901 F. Supp. 1122, 1124 (M.D. La. 1995). *But see RTC* Mortgage Trust 1994 N-1 v. F*Id.* Nat'l Title Ins. Co., 58 F. Supp. 2d 503 (D.N.J. 1999) (closing protection letter created "apparent authority" on the part of a title insurance agency to conduct a closing on behalf of the title insurance underwriter); Lawyers Title Ins. Corp. v. Dearborn Title Corp., 904 F. Supp. 818, 822-23 (N.D. 111. 1995) (denying motion to dismiss counterclaim under Illinois Title Insurance Act, where the counterclaim alleged that Lawyers Title "misrepresented the terms or conditions" of issuing agency agreement because, as the complaint alleged, "a lender receiving a closing protection letter would think that the named issuing agent was an escrow agent for Lawyers Title").

26. *Sears* Mortgage Corp. v. Rose, 634 A.2d 74 (N.J. 1993).

approved attorney's theft of settlement funds.[27] The court found that an agency relationship existed because the title insurer's failure to deal with customers directly (as title insurers do in southern New Jersey) forced its customer to deal with an approved attorney,[28] the title insurer exercised a degree of control over the approved attorney,[29] and the title insurer was in a better position than its customer to foresee and prevent defalcations by the approved attorney.[30] As an alternative ground for the court's holding, it ruled that a title insurance company's duty of good faith and fair dealing under New Jersey insurance law included the duty to apprize prospective insureds of the risk of defalcation by settlement attorneys and to offer insurance coverage to protect against that risk.[31] Having failed to perform that duty, the defendant title insurer was liable to the home buyers who were victimized by the settlement attorney. "Further, the court held that the title insurance industry's practice of issuing closing protection letters to institutional lenders would allow the court to "impute to a purchaser ... the reasonable expectation that his title-insurance carrier would undertake, on the payment of a full premium, to protect against all risks that could affect clear title to the property, including the antecedent risk that moneys furnished to remove liens would be misappropriated by the closing attorney."[33]

No court outside New Jersey has followed the holding in *Sears* that a title insurer's issuing agent or approved attorney is automatically the title insurer's agent for the purpose of conducting closings. It is not surprising that *Sears* has not been followed because the stark difference between title insurance practices in different parts of the state may be unique to New Jersey and because *Sears* cannot easily be reconciled with traditional principles of agency law. As noted above, most courts hold that the lack of communication between a title insurance company and its customer defeats

---

27. *Id.* at 84. The court held the title insurer liable for an approved attorney's theft of settlement funds, reasoning: "By dealing solely with approved attorneys rather than with their clients, [the title insurer] enabled the approved attorney to mislead or harm the purchaser. Commonwealth [the ride insurer] was in a position either to prevent or to protect against the loss suffered by Kaiser (the purchaser]." *Id.*

28. *Id.* at 82-83.

29. *Id.* at 83.

30. *Id.* at 83-84.

31. *Id.* at 86.

32. The court reasoned:

> [A]t the *very* least, Commonwealth had a dun? to inform Kaiser that there was a risk of attorney theft of closing funds, which might make his title unmarketable, and that he was not insured against such a risk. Obviously, to inform Kaiser of that omission of coverage, Commonwealth would have had to undertake some form of direct communication with him. However, the company's pragmatic business reasons for communicating only with attorneys cannot surmount its duty to its insured of good faith and fair dealing, including the obligation to disclose unprotected risks. *Id.*

33. *Id.*

the customer's claim that a settlement agent had apparent authority to conduct a closing on behalf of the insurance company. *Sears* inverted this rule by holding that the lack of communication between the title insurer and its customer was cause for finding that an approved attorney was the title insurer's agent for the purpose of conducting closings.

The *Sears* decision can best be understood as the court's response to a perceived need to establish rules to govern real estate closings in northern New Jersey.[34] The decision calls to mind Justice Holmes's observation that the "felt necessities of the time" shape the development of the common law more forcefully than does the application of logic.[35] A less activist court would have ruled for the title insurance company and, if it perceived widespread problems With the northern New Jersey practice, the court would comment in the opinion on the need for remedial legislation. One leading commentator has suggested that the holding in *Sears* and its companion case[37] may be partially explained by "the court's apparent repugnance at the insurer's attempt to recoup its loss" from the borrower under one of the mortgage loans after the title insurance company had reimbursed the

---

34. The *Sears* court went so far as to issue directives to title insurance companies as to how they should conduct their business, including a requirement that "the title insurance carrier must inform the attorney that he or she will be performing essential functions on behalf of the carrier and will be deemed to be the agent of the carrier, and further, that the carrier will prescribe the procedures for all disbursements." *Id.*

35. OLIVER WENDELL HOLMES, JR., THE COMMON LAW I (Little Brown and Co. 1945). According to Holmes:

> The life of the law has not been logic; it has been experience. The felt necessities of the time, the prevalent moral and political theories, institutions of public policy, avowed or unconscious, even the prejudices which judges share with their fellow men, have had a good deal more to do than the syllogism in determining the rules by which men should be governed.

36. Arizona and Virginia have used different ways to address legislators' concerns that a home buyer may lack an effective remedy for a settlement agent's misappropriation of closing funds. Arizona requires a "real property escrow agent" in connection with a sale of a "residential dwelling" to disclose that the title insurer may offer a closing protection letter, and, if the disclosure is not made, the title insurer for the transaction must "reimburse the buyer or seller, as applicable, for any escrow monies that are lost and that are not restored from the Arizona escrow recovery fund." ARIZ. REV. STAT. ANN,. §' 6-841.02 (B) (West 1999). Virginia's Consumer Real Estate Settlement Protection Act, VA. CODE ANN. §§ 6.1-2.19 to 6.1-2.29 (Michie 1999), requires that settlement agents be licensed, provides for periodic audits of their escrow accounts, and requires them to maintain fidelity bonds for the protection of their customers.

A Florida statute protects parties in addition to home owners by providing that a title insurer is liable for defalcation, conversion, or misappropriation of closing funds held in trust by a licensed title insurance agent. FLA. STAT. ANN. § 627.972 (West Supp. 2000). The statute is inapplicable to an approved attorney who is not a title insurance agent. Id The statute has been held inapplicable to an attorney-agent because attorneys may act as title insurance agents in Florida without obtaining a title insurance agent's license. Hechtman v. Nations Title Ins., 767 So. 2d 505 (Fla. Dist. Ct. App.), *amended* by 767 So. 2d 505 (Fla. Dist. Ct. App. 2000) (certifying question to the Florida Supreme Court).

37. Clients' Sec. Fund v. Sec. Title and Guar. Co., 634 A.2d 90 (NJ. 1993)

lender for the settlement agent's theft.[38] It seems unlikely that courts in other states will follow *Sears*.

II. THE ALTA FORM AND THE NATURE OF THE COMPANY'S CONTRACT

The standard ALTA closing protection letter form is phrased as an indemnity agreement. In a closing protection letter, the title insurance company agrees to reimburse the lender for actual loss incurred in connection with closings conducted by an issuing agent or an approved attorney.[39] An issuing agent is an agent authorized to issue policies on behalf of the title insurance company, while an approved attorney is an attorney upon whose certificates of title the title insurance company issues title insurance policies.[40] Closing protection letters covering loans secured by a mortgage on a one to four family dwelling protect the borrower as well as the lender.[41]

As a condition of the title insurance company's liability under an ALTA closing protection letter, title insurance from the company must have been "specified for [the lender's] protection in connection with closings of real estate transactions.[42] If an approved attorney conducts a closing, the lender may satisfy this condition only by obtaining a commitment for title insurance from the company or one of its issuing agents prior to transmitting settlement instructions to the approved attorney.[43]

Another condition of the title insurance company's liability under an ALTA closing protection letter is that the lender must provide the title insurance company with written acceptance of the closing protection letter.[44] The drafters of the ALTA closing protection letter seem to have expected that a title insurer would issue a single closing protection letter to each of its lender customers, and that this letter would cover all closings by the title insurer's issuing agents or approved attorneys. The closing protection letter could be supplemented from time to time with written confirmation that the settlement agent for any particular transaction was an issuing agent or approved attorney for the title insurer.

However, the single closing protection letter scheme has not worked well in practice. Busy loan processors at mortgage companies and loan

38. *J. BUSHNELL NIELSEN, TITLE & ESCROW* CLAIMS *GUIDE ' 14*.3 at 448 (Foundation Press 1996 and Cum. Supp. 2000).
39. ALTA Closing Protection Letter, at I of 4.
40. *Id.*
41. Id,
42. *Id.*
43. *Id.*, at I of 4, Conditions and Exclusions *I* B. This paragraph provides: "If the closing is to be conducted by an Approved Attorney, a title binder or commitment for the issuance of a policy of title insurance of the Company must have been received by you prior to the transmission of your final closing instructions to the Approved Attorney."
44. *Id.*, at 2 of 4.

production offices often lack the time to check with a lender's corporate headquarters to determine whether the lender has received a closing protection letter from the title insurance company designated for a transaction. Instead, the practice of lenders in many areas is to request a new closing protection letter for each loan closing. Because of the impracticality of obtaining a lender's signature on a closing protection letter for each transaction, many title insurers edit the ALTA form to delete the requirement for the lender's written acceptance.

Regardless of whether a lender accepts a closing protection letter, the letter creates no obligation on the part of the title insurer unless and until the lender orders title insurance from the company and delivers closing funds and documents to the settlement agent. As a general rule, closing protection letters require no promise or payment by the lender, except in the few areas of the country where the lender pays a fee for closing protection service.[45] The 1987 ALTA form of closing protection letter does not obligate the lender to purchase title insurance, nor does the letter obligate the lender to close any loan through any of the title insurer's approved attorneys or issuing agents. Instead, the title insurance company's undertakings under a closing protection letter are given in exchange for specific actions that the lender, at its option, may take in the future, such as providing funds and documents to an issuing agent or approved attorney in a transaction where the lender has ordered a title insurance policy from the particular title insurer.[46] Only after the lender has taken these actions does the closing protection letter obligate the title insurer to indemnify the lender for losses that arise out of a settlement agent's failure to comply with the lender's written closing instructions[47] or the settlement agent's

45. NIELSEN, *supra* note 38, §' 14.1 at 444 (noting "the lack of separate consideration for [a closing protection letter's] issuance"). *See* Metmor Financial, Inc. v. Commonwealth Land Title Ins. Co., 645 So. 2d 295 (Ala. 1993) (closing protection letter not insurance because insurance requires insured to pay premiums to insurance company and the insurance company placing those premiums in a central fund out of which claims would be paid); Fleet Mortgage Co. v. Lynts, 885 F. Supp. 1187, 1190 (E.D. Wis. 1995) ("Fleet paid no extra consideration for the closing letters"). However, in New Jersey and Pennsylvania, title insurance companies impose a charge for each closing protection letter.

46. But see Fleet Mortgage Corp., 885 F. Supp. at 1190 (closing protection letter was "part and parcel" of a title insurance policy, not a separate contract).

47. The ALTA Closing Protection Letter covers:

> Failure of the Issuing Agent or Approved Attorney to comply with your written closing instructions to the extent that they relate to (a) the status of the title to said interest in land or the validity; enforceability and priority of the lien of said mortgage on said interest in land, including the obtaining of documents and the disbursement of funds necessary to establish such status of title or lien, or (b) the obtaining of any other document, specifically required by you, but not to the extent that said instructions require a determination of the validity, enforceability or effectiveness of such other document, or (c) the collection and payment of funds due you....

ALTA Closing Protection Letter. at 1 of 4.

fraud or dishonesty in handling the lender's funds or documents.[48] Thus, closing protection letters fall within a category of contracts known as unilateral contracts, which are defined as contracts in which one party's offer is accepted through the other party's performance rather than by a reciprocal promise.49

A title insurance company's liability under a closing protection letter is not conditioned on the ultimate issuance of a title insurance policy. Indeed, a settlement agent's acts that create liability under a closing protection letter may, in some cases, preclude the issuance of a policy. Such acts may include the settlement agent's failure to make a payoff or to satisfy some other requirement specified in a commitment for title insurance.[50]

Negligence on the part of a settlement agent in conducting a closing will not give rise to liability under a closing protection letter, unless the error or omission constituted a failure to comply with the lender's written closing instructions. Losses caused by a settlement agent's failure to follow the lender's written closing instructions are covered only insofar as the instructions relate to: (a) the status of title or the validity, enforceability, or priority of an insured mortgage, including instructions to obtain documents or disburse funds necessary to establish the lien of a mortgage, (b) obtaining any other document required by the tender, but not to the extent that the instructions require the settlement agent to determine the validity, enforceability, or effectiveness of that document, or (c) the collection of any funds owed to the lender.[51]

The ALTA closing protection letter disclaims liability for losses arising out of an approved attorney's failure to comply with closing instructions that require title insurance protection inconsistent with a title insurance binder or commitment issued by the title insurance company.[52] However, instructions are not deemed inconsistent with the binder or commitment if the instructions: (1) require the removal of specific exceptions to title; or (2) require compliance with requirements contained in a title insurance binder or commitment.[53] A lender's instructions to an issuing agent need not be consistent with a title insurance binder or commitment previously

48. The letter also covers "[flraud or dishonesty of the Issuing Agent or Approved Attorney in handling your funds or documents in connection with such closings." *Id.*
49. RICHARD A. LORD, WILLISTON ON CONTRACTS § 1. 17 at 41-48 (4th ed. 1990).
50. Lawyers Title Ins. Corp. v. Edmar Constr. Co., Inc., 294 A.2d 865, 866 (D.C. 1972) (approved attorney's failure to pay off second mortgage meant that a condition of issuing proposed title insurance policy went unsatisfied, and tender not entitled to receive title insurance policy). For a further illustration that a title insurance policy is a contract separate from a closing protection letter, *see* First Am. Title Ins. Co. *v.* Vision Mortgage Corp., 689 A.2d 154 *(N.J.* Super. App. Div. 1997) (lender had no claim under title insurance policy but nevertheless had valid claim under closing protection letter issued for same transaction).
51. ALTA Closing Protection Letter, at 1 of 4.
52. *Id.*, at I of 4, Conditions and Exclusions ¶A. I
53. *Id.*

issued by the agent, presumably because an issuing agent's authority to issue binders or commitments includes the authority to amend the binders or commitments. An approved attorney, in contrast, has no authority to issue or to amend title insurance binders or commitments.

Other exclusions from liability include losses caused by, bank failures, except where the settlement agent has failed to comply with the lender's instructions to deposit funds in a particular bank,[54] or losses arising out of mechanics' or materialmen's liens, except to the extent that a title insurance binder, commitment, or policy protects the lender against those kinds of liens.[55] The title insurer's liability under the ALTA closing protection letter is reduced to the extent that the lender knowingly and voluntarily impairs the insurer's right of subrogation.[56]

The ALTA closing protection letter also provides that the title insurance company's liability for losses incurred by the lender in connection with closings by an issuing agent or approved attorney "is limited to the protection provided by this letter."[57] The purpose of this limitation is to circumscribe the title insurer's liability by the four comers of the closing protection letter. As discussed above, lenders sometimes claim, usually without success, that a settlement agent is a title insurer's agent for the purpose of conducting a closing, and that the title insurance company therefore should be held vicariously liable for the settlement agent's misconduct under the doctrine of respondeat superior.[58] The ALTA form's limitation of the title insurer's liability to the terms of the closing protection letter should protect the insurance company from potentially greater liability that could arise if an issuing agent or approved attorney were found to have actual or apparent authority to conduct closings on behalf of the title insurance company. However, the ALTA form specifies that the closing protection letter's limitation of liability does not diminish the protection afforded by a title insurance binder, commitment, or policy issued to the lender.[59]

In October 1988, ALTA adopted three variations of its closing protection letter form: a "Regulatory" form addressing insurance commissioners' concerns regarding the 1987 ALTA form,[60] a "Nonresidential Limitations" form that limits the title insurer's liability to a specified dollar amount in closings that involve nonresidential properties,[61] and a "Single Transaction

54. *Id.*, at I of 4, Conditions and Exclusions ¶ A.2.
55. *Id.*, at I of 4, Conditions and Exclusions ¶ A.3.
56. *Id.*, at 1-2 of 4, Conditions and Exclusions ¶ C.
57. *Id.*, at 2 of 4, Conditions and Exclusions ¶ D.
58. *See* discussion in section I *infra*.
59. ALTA Closing Protection Letter, at 1-2 of 4, Conditions and Exclusions ¶ C.
60. AMERICAN TITLE INSURANCE ASSOCIATION, POLICY FORMS HANDBOOK § VI-2(a) [hereinafter ALTA Closing Protection Letter- Regulatory].
61. *Id.* at § VI-2(b).

Limited Liability" form intended for one-time use in a transaction that exceeds the limit set forth in a "Nonresidential Limitations" closing protection letter.[62] The concerns that gave rise to the Regulatory form are discussed in the next section of this article.

III. ARE CLOSING PROTECTION LETTERS INSURANCE?[63]

Whether closing protection letters constitute insurance is neither simple nor academic. The answer to this question has important implications for such diverse issues as whether a plaintiff suing on a closing protection letter may recover attorneys' fees,[64] whether a closing protection letter claim is covered by a title insurance policy's arbitration clause,[65] and whether a title insurer even has the legal authority to issue a closing protection letter.[66] The cases and regulatory opinions that have addressed the question are divided.[67]

A closing protection letter undoubtedly constitutes an indemnity agreement, which is broadly defined as any contract whereby one party, die indemnitor, agrees to reimburse a loss sustained by another party, the indemnitee.[68] In issuing a closing protection letter, the title insurer assumes the role of indemnitor, obligating itself to reimburse the lender or a purchaser, as indemnitee, for actual loss or damage caused by certain kinds of errors by settlement agents in connection with real estate closings. However, not all indemnity agreements are insurance,[69] so it is necessary to consider the title insurer's obligation more fully.

In states that have enacted statutes defining title insurance, closing protection letters may fall outside the statutory definition.[70] The kinds of risk covered by closing protection letters differ substantially from the kinds of risk covered by title insurance policies, although some of the risks overlap.

---

62. *Id.* at § VI-2(c).

63. A prior version of this section of the article appeared in James B. Davis, Are Closing Protection Letters Insurance?, ABA TORT & INS. INS. PRACTICE SECTION, TITLE INSURANCE LITIGATION COMMITTEE NEWS (Summer 2000).

64. Metmor Financial, Inc. v. Commonwealth Land Title Ins. Co., 645 So. 2d 295 (Ala. 1993).

65. Fleet Mortgage Corp. v. Lynts. 885 F. Supp. 118"? (E.D. Wis. 1995).

66. NIELSEN, *supra* note 38, § 14.1 at 444,

67. Compare Metmor, 645 So. 2d at 295 (closing protection letters not insurance) with Clients' Sec. Fund v. Sec. Title and Guar. Co., 634 A2d 90 (N.J. 1993) (closing protection letters constitute insurance).

68. Indemnity means "[a] duty to make good any loss, damage or liability incurred by another." BLACK'S *LAW DICTIONARY 772* (7th ed. 1999).

69. LEE Russ & THOMAS SEGALLA, COUCH ON INSURANCE 3d. § 1:7 at 1-13 (1997) ("While a policy of insurance, other than life or accident insurance, is basically a contract of indemnity, not all indemnity contracts are insurance contracts; rather, an insurance contract is one type of indemnity contract.").

70. *Id.* (quoting ALA. CODE § 27-5-10 (1975)).

Title insurance policies are often said to look backward because they insure against matters adverse to title that came into being, if at all, prior to the effective date of the policy.[71] Although title insurance policies cover some off-record risks, their focus is to insure the status of title as disclosed by the public records on the date that the insured acquired an interest in real estate.[72] Closing protection letters, in contrast, look forward. They protect the addressee against the risk of future events, actions that a settlement agent might take or fall to take in connection with a closing. Based on these differences, the Alabama Supreme Court held that closing protection letters fell outside the state's statutory definition of title insurance as insurance "against loss by encumbrance, or defective titles, or invalidity or adverse claim to title."[73]

Risk spreading, or the lack of it, provides another basis for distinguishing a closing protection letter from an insurance policy. The Alabama Supreme Court's holding that closing protection letters are not insurance arose in the context of a lender's suit against a title insurance company for "bad faith" failure to pay a claim. In that case, the lender sought to recover its attorneys' fees incurred in suing the title insurance company for breach of a closing protection letter. Although Alabama usually follows the "American" rule that requires each party to a suit to pay its own attorneys' fees, Alabama allows a policyholder to recover attorneys' fees incurred as a result of an insurance company's bad-faith failure to pay a valid claim under an insurance policy. In denying the proposed attorneys' fee award, the court held that closing protection letters lack two essential attributes of insurance-payment of a premium to the insurance company and the insurance company's deposit of premiums received into a separate fund to cover losses.[75]

Following the same line of reasoning, a federal district court in Florida held that closing protection letters might not constitute insurance as defined in the McCarran-Ferguson Act, which exempts the business of insurance from the Sherman Antitrust Act.[76] The court reasoned that spreading of

---

71. See Carstensen v. Chrisland Corp., 442 S.E.2d 660, 665 (Va. *1994)* (describing the business of title insurance as "to provide insurance coverage for the validity of title to the extent diligent examination could or should have discovered defects at the time of policy issuance"). *See generally* BARLOW BURKE, LAW OF TITLE INSURANCE § 2.01 [B] at *2* -16 (3d ed. 2000) ("Title Insurance is based in large part on the work of an abstractor-that is, on the work of a person who searches the public records maintained for interests in real property to ascertain if defects already exist in a title. The abstractor searches for preexisting defects, arising in past transactions, which may be asserted in the future.").

72. Carstensen, 442 S.E.2d at *665.*

73. Id. (quoting *ALA.* CODE § *27-5-10 (1975)).*

74. Metmor Financial, Inc. v. Commonwealth Land Title Ins. Co., *645* So. 2d *295, 297* (Ala. *1993).*

75. Id.

76. Escrow Disbursement Ins. Agency, Inc. v. Am. Title Ins. Co., *550 F. Supp. 1192 (S.D.* Fla. *1982).* A cogent analysis of this case appears in Shawn G. Rader, *Closing Protection Letters,* FLA. B.J., Dec. 1996, at 30.

risk is the defining characteristic of insurance under the McCarran-Ferguson Act and that closing protection letters do not spread risk.[77]

Another line of cases holds that closing protection letters are insurance. In the view of those authorities, closing protection letters are inseparable from title insurance policies. In *Sears*, the New Jersey Supreme Court held that a title insurance policy itself insures against defalcation by a settlement agent.[78] In a companion case, the same court held that a lender that sued a title insurer to recover for a settlement agent's defalcation was entitled to recover his attorneys' fees, a remedy that New Jersey law allows to an insured who successfully sues his or her insurance company to establish policy coverage.[79] This decision rested on *Sears's* view that protection against a settlement agent's misconduct was an implied obligation "derived from the title insurance policy."[80]

Citing *Sears*, a federal district court in Wisconsin concluded that closing protection letters are insurance in holding that a title insurance policy's arbitration clause applied to a claim under a closing protection letter.[81] The court cited several grounds for this holding. State public policy favored arbitration,[82] and the title insurance policy contained a broad arbitration clause that encompassed any claim "arising out of or relating to this policy, any service of the Company in connection with its issuance or the breach of a policy provision or other obligation."[83] Finally, the court cited *Sears* for the proposition that closing protection letters are "part and parcel of title insurance."[84]

The author disagrees that closing protection letters and title insurance policies are part and parcel of the same obligation. As shown above, closing protections letters and title insurance policies are different agreements that cover different kinds of risk. A title insurance company may be held liable for losses covered by a closing protection letter even if no title insurance

77. Escrow *Disbursement,* 5 50 F. Supp. at 1197.
78. *Sears* Mortgage Corp. v. Rose, 634 A.2d 74, 88 (N.J. 1993).
79. Clients' Sec. Fund *v.* Sec. Title and Guar. Co., 634 A.2d 90 (N.J. 1993).
80. *Sears,* 634 A.2d at 88.
81. Fleet Mortgage Corp. *v.* Lynts, 885 F. Supp. 1187 (E.D. Wis. 1995).
82. *Id.* at 1188-89.
83. *Id.* (emphasis in original). The court in *Fleet* reasoned that if a closing protection letter was not considered part of a title insurance policy, the closing protection letter would be unenforceable for lack of consideration. This reasoning is unpersuasive because it falls to recognize that a closing protection letter is a unilateral contract. Except in the few states where title insurers charge for the issuance of closing protection letters, the consideration for a closing protection letter is not the issuance of a title insurance policy, but rather the lender's entrustment of loan funds and documents to a title insurer's issuing agent or approved attorney when title insurance has been ordered. *See* discussion in section 11 *infra.* The title insurance company's obligation under a closing protection letter is not conditioned on the ultimate issuance of a title insurance policy.
84. *Fleet,* 885 F. Supp. at 1189 (citing *Sean,* 634 A.2d at 86).

policy is ever issued,[85] and closing protection letters have been held to cover losses that would not be covered by a title insurance policy.[86] Whether or not a closing protection letter constitutes insurance should be answered on more persuasive grounds than the erroneous proposition that a closing protection letter and the associated title insurance policy constitute the same obligation.

A third group of authorities holds that closing protection letters are insurance, but not title insurance. These rulings arose when state regulatory authorities questioned the authority of title insurers to issue closing protection letters. The New York Insurance Commissioner ruled that a closing protection letter "is in the nature of fidelity or surety coverage, or resembles professional liability insurance against legal malpractice,"[87] and therefore falls "beyond the scope of the monoline title insurer's license and writing authority."[88] Kansas likewise prohibits the use of closing protection letters.[89] These rulings rest on the premise that closing protection letters constitute a form of insurance outside the scope of the monoline insurance that title insurers are authorized to provide.

Regulatory authorities in other states have come to the same conclusion regarding the 1987 ALTA closing protection letter form, but have allowed closing protection letters that provide more limited coverage.[90] In a 1995 ruling, Virginia's Insurance Commissioner instructed title insurers that "closing protection letters may not be used to indemnify lenders for losses that are unrelated to the condition of the title to property or the status of any lien on property."[91] Title insurance companies doing business in Virginia addressed the Commissioner's concerns with a revised closing protection letter form similar to the current ALTA Regulatory form. The Regulatory form, adopted three years later, provides that a title insurer will be liable for a settlement agent's fraud, dishonesty, or failure to follow instructions only to the extent that the fraud, dishonesty, or failure affects

85. Lawyers Title Ins. Corp. *v.* Edmar Constr. Co., 294 A.2d 865, 866 (D.C. 1972).

86. First Am. Title Ins. Co. v. Vision Mortgage Corp., 689 A.2d 154 (N.J. Super. App. Div. 1997).

87. Circular Ltr. No. 18 (1992) by Hon. Salvatore R. Curiale, Superintendent of Insurance of the State of New York (Dec. 14, 1992), ***quoted in*** NIELSEN, *supra* note 38, § 14.1 at 444-45.

88. *Id.*

89. NIELSEN, *supra* note 38, § 14.1 at 445.

90. *Id.* Nielsen reports that insurance commissioners in Nebraska, Washington, Wisconsin, and Virginia have allowed some for-in of closing protection letter, but have required modifications of the coverage provided by the ALTA form. *Id.* In Nebraska, a statute now specifies the kind of closing protection letter that a title insurance company may issue, essentially limiting the title insurance company's liability in the same way as the ALTA Regulatory form. NEB. REV. STAT. ANN. § 44-1984 (LEXIS 2000).

91. Admin. Ltr. 1995-8 by Hon. Steven T. Foster, Commissioner of Insurance of the Commonwealth of Virginia, to All Companies Licensed to Write Title Insurance in Virginia (Sept. 4, 1995).

or relates to "the status of title" or to "the validity, enforceability or priority" of a mortgage.[92]

Statutes in Texas and Florida resolved the regulatory concern by specifically authorizing title insurance companies to issue closing protection letters, using a form to be prescribed by state insurance regulators.[93] A Nebraska statute authorizes title insurance companies to issue closing protection letters, but limits the risks that the letters may cover.[94] Illinois recently adopted legislation defining the title insurance business as including issuing closing protection letters, when done in contemplation of issuing title insurance.[95]

Because the states have the power to regulate insurance companies and to define the insurance business, this article cannot propose a universal answer to the question of whether closing protection letters constitute insurance. In states where the question remains undecided, the answer probably will depend on such issues as whether risk spreading is the defining characteristic of insurance under state law, whether closing protection letters actually spread risk, and whether closing protection letters come within a statutory definition of title insurance. The rights and obligations that may be affected by the answer include whether a title insurance company has authority to issue closing, protection letters and whether the "good-faith" obligations that attach to insurance policies apply to closing protection letters.

IV. WHO MAY ENFORCE A CLOSING PROTECTION LETTER

A leading treatise asserts that a closing protection letter is intended to benefit only the addressee, usually a lender.[96] This interpretation flows naturally from the language of the ALTA closing protection letter that expresses no intention to benefit any lender other than the addressee. The only third-party beneficiary named in the ALTA closing protection letter, is the borrower, provided that the lender-addressee of a closing protection letter is making a loan secured by a one to four unit residence. This contrasts with the ALTA loan policy form that defines an insured to include not only the original lender but also an assignee of a mortgage loan.[97]

---

92. ALTA Closing Protection Letter-Regulatory, at 1 of 2, ¶ 2.
93. FLA. STAT. ANN. ' 627.786 (West Supp. -1000); TEX. INS. CODE ANN. § 9.49 (West 2000).
94. NEB. REV. STAT. ANN. § 44-1984 (LEXIS 2000).
95. ILL. COMP. STAT. ANN., P.A. 91-0159 (West 2000).
96. *See* NIELSEN, *supra* note 38, § 14 at 441 ("The insurer's duties are undertaken for only the addressee on the Letter.").
97. The ALTA 1992 loan policy form defines "insured" as "the insured named in Schedule A," and provides that the "insured" also includes "the owner of the indebtedness secured by the insured mortgage and each successor in ownership…AMERICAN TITLE INSURANCE AS-

The title insurer's purpose in issuing a closing protection letter is entirely consistent with an intention to benefit only the original lender. As shown above, a closing protection letter promotes a title insurer's business by protecting a lender that entrusts loan funds or documents to a title insurer's issuing agent or approved attorney.[98] Only the original lender takes these actions. An assignee who acquires a loan from the original lender entrusts no money or documents to an issuing agent or approved attorney; instead, the assignee simply pays money to the original lender in exchange for an assignment of the mortgage loan documents. Nevertheless, assignees sometimes claim to be third-party beneficiaries of closing protection letters issued to the lenders that originated the loans.[98] No court appears to have ruled directly on the merits of this contention; instead, the courts have ruled against the assignees on other grounds.

*In First Financial Savings & Loan Ass'n v. Title Insurance Co. of Minne*sota,[100] an assignee of mortgage loans from a bankrupt lender found that the loans were unenforceable because the lender never advanced the loan proceeds to the borrowers. The assignee then sued the settlement attorney and the title insurer to recover the loss. The court held that the assignee's complaint stated a cause of action against the settlement attorney but not against the title insurer. In dismissing the claim against tile title insurance company, the court held: "[E]ven assuming that plaintiff is a beneficiary under the insured closing letter, there was no loss for which the letter provided protection."[101] Because the original lender never provided the settlement attorney with good funds, the assignee's loss was not caused by any loss of funds transmitted to the settlement attorney. Therefore, the loss fell outside the scope of risks covered by the closing protection letter.

The same result may follow from an assignee's lack of any direct contact or privity with the settlement agent. In *Jefmor, Inc. v. Chicago Title Insurance Co.,*[101] the court held that neither the settlement agent nor the title insurer had any liability to an assignee for a misleading HUD-1 settlement statement prepared by the settlement agent. The HUD-1 statement represented that loan funds had been advanced to a borrower, but the lender

---

SOCIATION, POLICY FORMS HANDBOOK § 11-1, at 6 of 12, Conditions and Stipulations I I (a) [hereinafter ALTA Loan Policy Form]. The definition of "insured" goes on to exclude certain kinds of successors, e.g., a person obligated on the mortgage loan who acquires the insured mortgage by reason of payment under a guaranty or similar instrument. *Id.*

98. Lawyers Title Ins. Corp. v. Edmar Constr. Co., 294 A.2d 865, 866 (D.C. 1972).

99. This position was asserted by the assignees of multiple subprime mortgage loans that were sued by home purchasers in the case of *Peaks v. A Home of Your Own,* No. 98022011 (Cir. Ct. of Baltimore, Md., filed Jan. 21, 1998). The coverage dispute between the assignees and the title insurers was settled without litigation.

100. 557 F. Supp. 654 (N.D. Ga. 1982).

101. *First Financial Savings & Loan,* 557 F. Supp. at 662.

102. 839 S.W.2d 161 (Tex. Ct. App. 1992).

had never funded the loan, even though the lender had received funds from the assignee for that purpose. The court rejected the assignee's claim because, under Texas law, a person making a misrepresentation is accountable only to the person whom he or she seeks to influence.[103] Because the HUD-1 statement was directed to the original lender, not the assignee, the assignee had no claim against either the settlement agent or the title insurance company for the settlement agent's misrepresentation that the loan funds had been advanced. Although the court made no reference to a closing protection letter, the ruling that the agent had no liability to the assignee would appear to shield a title insurer from any vicarious liability to the assignee for the settlement agent's misconduct. A similar result may be expected in states holding that a settlement agent's duties do not extend to nonparties to the escrow.[104]

Assignees seeking to recover under a closing protection letter have based their arguments on three grounds: (1) an assignee sometimes purchases a mortgage loan immediately when the loan is made and even supplies the money for the original lender to advance to the borrower; (2) originating lenders customarily include closing protection letters with the loan document package provided to assignees; and (3) a closing protection letter is closely connected to the issuance of the title insurance policy to the original lender and ought to be considered part of the policy.[105] The answer to each of these arguments is that the title insurance company's liability to an assignee must originate in contract, and the ALTA closing protection letter, in contrast to the ALTA loan policy, expresses no intention to protect an assignee.

Title insurance companies need no justification for refusing to cover assignees under closing protection letters. Insurance companies are free to contract as they choose, as long as they comply with laws regulating the insurance business and do not violate antidiscrimination laws.[106] If some justification were required for treating an assignee differently from the original lender, the justification would be found in the purpose of a closing

---

103. *Jefmor,* 839 S.W.2d at 163.

104. Mark Props, Inc. v. Nat'l Title Co., No. 3 2954, 2000 Nev. LEXIS 134, at *11 (Nev. Dec. 15, 2000).

105. Assignees' counsel made these three arguments in connection with *Peaks v. A Home of Your Own, No.* 98022011 (Cir. Ct. of Baltimore,Md., filed Jan. 21,1998). No court decision would appear to support either of the first two arguments. *Sears's* characterization of a closing protection letter as "part and parcel" of a title insurance policy might be cited in support of the third argument. However, as explained above, the better view is that a closing protection letter is a contract separate and distinct from any title insurance policy.

106. *See, e.g.,* WE. Erickson Constr., Inc. v. Chicago Title Ins. Co., 641 N.E.2d 861, 865 all. App. 1994) (Enforcing an exclusive remedy provision in an ALTA title insurance commitment form, the court held: "An exclusive remedv clause will be enforced unless it violates public policy, or something in the social relationship of the parties works against upholding the clause."). *See generally* 43 AM. JUR. *2D, Insurance* § 360 (1982 & Supp. 2000).

protection letter. That purpose, as noted above, is to encourage lenders to do business with the title insurance company's issuing agents and approved attorneys, not to elicit business from assignees. As illustrated by *First Financial*, it is the lenders, not the assignees, that place title orders and that entrust settlement agents with loan funds and documents.

V. SCOPE OF LIABILITY AND MEASURE OF DAMAGES

In a simple theft of settlement funds, the contract measure of damages under a closing protection letter is easy to apply: the title insurer must reimburse the lender for the funds lost.[107] However, the measure of damages becomes less clear when a settlement agent violates the lender's closing instructions, but nevertheless provides the lender with a valid mortgage. Absent a title defect, the lender will have no right to indemnity under its title insurance policy, but may have a claim under a non-Regulatory form of closing protection letter. Also, lenders have claimed that a title insurer's liability under a closing protection letter includes damages that would not be recoverable under a title insurance policy, such as lost profits, delay damages and incidental expenses. The two reported cases that addressed this subject reached opposite results.

Herget National Bank v. USLife Title Insurance Co.[108] held that a lender's right to recover under a closing protection letter is limited to the amount of loan funds advanced, plus interest. A group of participating banks had made a residential construction loan on the condition that the borrower would obtain a commitment from the Government National Mortgage Association[109] to provide permanent financing when the construction was completed. Unfortunately for the lenders, the title insurance agent who closed the transaction misapplied the part of the loan proceeds that had been earmarked for the GNMA commitment fee. Without permanent financing from GNMA, the banks had to arrange for alternative permanent financing. Ultimately, the loan was repaid. However, the banks failed to earn the profits that they expected, they had to purchase a new permanent loan commitment, and they incurred legal fees in suing the settlement agent and an affiliated mortgage broker. After the repayment, the banks brought suit against the title insurance company for their lost profits and costs of collection, claiming that these losses were recoverable under a closing protection letter that covered "any loss of your settlement funds

107. As noted above, the ALTA closing protection letter obligates the title insurance company to "reimburse" the lender for "actual loss incurred by you" when the loss arises out of " "[f]raud or dishonesty of the Issuing Agent or Approved Attorney in handling your funds or documents" in connection with loan closings. ALTA Closing Protection Letter, at 1 of 4.

108. 809 F.2d 413 (7th Cir. 1987).

109. Hereinafter GNMA.

transmitted by you to [our issuing agent] where loss results from [the agent's] fraud or dishonesty."[110]

Although the jury in *Herget National Bank* rendered a verdict in favor of the banks, the trial court entered judgment in favor of the title insurer. The trial court concluded that no settlement funds had been lost because the construction loan had been repaid. The trial court also held that the closing protection letter did not cover incidental expenses, such as "attorneys' fees, lost profits and miscellaneous expenses."[111] On appeal, the U. S. Court of Appeals for the Seventh Circuit affirmed these rulings and rejected the banks' argument that they had a night to apply the amounts recovered to expenses and lost profits before crediting any amount to principal and interest. The appellate court held that, under applicable Illinois law, the banks' proposed allocation of the recovery would "work an injustice" to the title insurer by enlarging its liability beyond the closing protection letter's coverage of lost settlement funds.[112] In the court's view, once the banks recovered "the amount of the loan plus interest," there was no loss of settlement funds for which the title insurer could be held responsible, and "[i]t would be inequitable to require USLife to 'pick up the tab' for an expense against which it did not insure."[113]

In contrast to *Herget National Bank,* the court in *First American Title Insurance Co. v. Vision Mortgage Corp.*[114] awarded a defrauded mortgage lender the full deficiency balance after a foreclosure sale, including the costs of the foreclosure.[115] The court also awarded the lender its attorneys' fees incurred in suing the title insurance company, as allowed under New Jersey law.[116] However, these aspects of the measure of damages received little discussion in the court's opinion. The main question in *Vision Mortgage* was whether the title insurance company could be held liable for mortgage gage fraud committed by an approved attorney where the lender's loss did not result from any defect in the insured title. The court held that it could, as will be discussed more fully below.

Herget National Bank and *Vision Mortgage* illustrate that the measure of damages under a closing protection letter depends, at least in part, on how indemnity agreements are interpreted under laws of different states. Other factors affecting the damages that a lender may recover under a closing

---

110. *Herget National Bank, 809* F.2d at 416.
111. *Id.*
112. *Id.* at *418.*
113. *Id.*
114. *689* A.2d 154 (N.J. Super. Ct. App. Div. *1997)*
115. *Vision Mortgage, 689* A.2d at *156.* The trial court's damage calculations began with the lender's "Total Loss" of approximately $278,*645,* from which the court deducted net resale proceeds of approximately $127,326. The "Total Loss" included "PROPERTY DISPOSITION " costs of $7,119 that presumably reflect foreclosure sale expenses. *Id.*
116. *Id.* at 157.

protection letter include: (1) the language of the closing protection letter, which may vary from state to state; (2) whether the lender's loss arises from a title defect that would be covered by a title insurance policy; and (3) whether a closing protection letter constitutes insurance under applicable state law. The paragraphs that follow will discuss each of these factors in turn.

Not all closing letters provide the same coverage. The 1987 ALTA closing protection letter places no restriction on the kind of "actual loss incurred" that the title insurance company must reimburse if a settlement agent acts fraudulently or dishonestly in handling the lender's funds or documents. In contrast, ALTA's Regulatory form of closing protection letter covers such losses only "to the extent such fraud or dishonesty relates to the status of title" or to the "validity, enforceability and priority" of an insured mortgage.[117] Thus, the coverage provided by the 1987 ALTA form is broader than the coverage provided by the Regulatory form.

Vision Mortgage construed the 1987 ALTA form to cover losses that did not arise out of a title defect. The borrower in *Vision Mortgage* defrauded the lender by applying for a purchase money mortgage in the name of a different, more creditworthy person. With the assistance of the settlement attorney, the imposter forged the purported borrower's signature on the mortgage loan documents and took title to the property in the name of the ostensible borrower. When the lender discovered the fraud and made a claim under a closing protection letter, the title insurance company denied liability on the ground that there was no title defect, i.e., the mortgage was valid because the imposter had acquired legal title to the property (albeit in a false name) and had signed the mortgage instrument, thereby creating a valid first lien in favor of the lender. The title insurer also argued that the lender caused its own loss by lending more money than the house was worth.[118]

The court rejected these arguments, holding that the settlement attorney's fraud came within the protection of the closing protection letter. Because the loan was not made to the borrower whose credit the lender had approved, the lender was subjected to an increased risk of default, and could not obtain a deficiency judgment against the approved borrower if foreclosure sale proceeds were insufficient to repay the loan.[119] Citing

---

117. ALTA Closing Protection Letter-Regulatory, at 1 of 2.

118. The court summarized the title insurance company's position:

> The gravamen of this argument is that the focus of the Closing Protection Letter is to secure first hen status for the lender's mortgage, backed up by a title insurance policy, and that this is exactly what Vision received. According to First American, any loss Vision sustained was the result of its overvaluation of the property in the first place. *Id.* at 156.

119. *Vision Mortgage,* 689 A.2d at 157.

Sears, the court also held that the lender's "careless valuation of the property" would not excuse the title insurance company from liability because the title insurer was "in the best position to prevent the loss created by the fraud and defalcation of the Approved Attorney."[120]

One commentator has argued that the decision in *Vision Mortgage* goes too far because the "lender, not the [title] insurer, is in the best position to prevent loan fraud."[121] This view fails to take into account that the 1987 ALTA form of closing protection letter includes a specific undertaking to reimburse the lender for loss or damage arising out of "[f]raud or dishonesty of the Issuing Agent or Approved Attorney in handling your funds or documents ...."[122] The comparative abilities of the title insurer and the mortgage lender to prevent fraud do not alter the title insurer's promise to reimburse the lender for losses resulting from the settlement agent's fraud or dishonesty in connection with a closing. If a lender's loss arises out of a risk covered by the closing protection letter, the title insurance company has a contractual obligation to reimburse the loss, unless exceptional circumstances excuse the performance of that obligation.

Under the more limited coverage provided by the Regulatory form of closing protection letter, a lender should not be able to hold a title insurer responsible for fraudulent or dishonest conduct by a settlement agent that does not cause a title defect or impair validity, priority, or enforceability of the lender's mortgage. If *Vision Mortgage* had been decided in a state that uses the Regulatory form, the lender could not have recovered from the title insurer because the lender received the title it bargained for, even though the mortgage was granted by an imposter.

The issuance of a title insurance policy may also affect a title insurer's liability under a closing protection letter. ALTA's loan policy form contains an integration clause that merges into the policy all prior dealings between the title insurer and an insured lender concerning the status of the insured title.[123] If this clause is given effect, the lender's title insurance policy will supersede the closing protection letter as to any claim arising out of a title defect or out of any invalidity, unenforceability, or lack of priority over the insured mortgage.

With regard to claims arising out of a title defect, the policy, in many ways, is more favorable to the title insurer than a closing protection letter.

---

120. *Id.*
121. NIELSEN, *supra* note 38, § 14.2 at 90.
122. ALTA Closing Protection Letter, at 1 of 4.
123. The clause states:

Any claim of loss or damage, whether or not based on negligence, and that arises out of the status of the lien of the insured mortgage or of the status of title to the estate or interest covered hereby or by any action asserting such claim. shall be restricted to this policy. ALTA Loan Policy Form, at 12 of 12, Conditions and Stipulations ¶ 14(b).

Unlike the 1987 ALTA closing protection letter, the ALTA title insurance policy provides that the title insurer may fulfill its duties to the insured by establishing the title as insured within a reasonable time,[124] and the policy allows the title insurer to bring litigation to cure a title defect.[125] If the title insurer succeeds in solving the lender's title problem, these provisions of the policy should bar the lender from recovering lost profits or delay damages, which might be available under a closing protection letter claim. Other provisions of the ALTA policy give the title insurer the right to limit its losses to the face amount of the title insurance policy or the amount outstanding under the lender's loan, whichever is less.[126]

The policy's integration clause is not unreasonable in relation to either the language or the purpose of closing protection letters. A lender that accepts an ALTA closing protection letter intends to obtain an ALTA insurance policy because the title insurer's liability under a closing protection letter is expressly made conditional on the lender having ordered title insurance from that insurance company. The standard ALTA forms of title insurance commitment and policy provide that the insurer's liability for title defects will be limited to the obligations set forth in the policy and that the policy will supersede all prior obligations of the title insurance company concerning the status of title.[127] Therefore, a lender cannot rea-

---

124. The ALTA title insurance policy states:

> If the Company establishes the title, or removes the alleged defect, lien or encumbrance, or cures the lack of a right of access to or from the land, or cures the claim of unmarketability of title, or otherwise establishes the lien of the insured mortgage, all as insured, in 2 reasonably diligent manner by any method, including litigation and the completion of any appeals therefrom, it shall have fully performed its obligations with respect to that matter and shall not be liable for any loss or damage caused thereby.

Id. at 10 of 12, Conditions and Stipulations ¶ 8(a).

125. According to the policy:

> The Company shall have the right, at its own cost, to institute and prosecute any action or proceeding or to do any other act that in its opinion may be necessary or desirable to establish the title to the estate or interest or the lien of the insured mortgage, as insured, or to prevent or reduce loss or damage to the insured.

Id., at 7 of 12, Conditions and Stipulations ¶ 4(b).

126. ALTA Loan Policy Form, at 8-9 of 12, Conditions and Stipulations ¶ 6(a).

127. The ALTA's 1966 form of title insurance commitment provides, among other things, that the title insurance company's liability "is subject to the insuring provisions and Conditions and Stipulations and the Exclusions from Coverage" contained in the title insurance policy to be issued pursuant to the commitment. AMERICAN TITLE INSURANCE ASSOCIATION, POLICY FORMS HANDBOOK § III-1, at 4 of 4, Conditions and Stipulations ¶ 3. The ALTA Loan Policy Form confirms this, providing:

> (a) This policy together with all endorsements, if any ... is the entire policy and contract between the insured and the Company.
>
> (b) Any claim of loss or damage, whether or not based on negligence, and that arises out of the lien of the insured mortgage or of the title to the estate or interest covered hereby or by any action asserting such claim, shall be restricted to this policy.

ALTA Loan Policy Form, at 12 of 12, Conditions and Stipulations ¶ 14(a) and (b).

sonably expect that a title insurer, by issuing a closing protection letter, has undertaken any greater obligation with regard to the status of title. However, *Vision Mortgage* illustrates that a title insurance policy may not supersede the coverage of a 1987 ALTA closing protection letter as to matters unrelated to the status of title.

Whether a lender may recover its attorneys' fees for pursuing a claim against a title insurer under a closing protection letter may depend on whether applicable state law considers a closing protection letter to be insurance. As noted above, some states consider closing protection letters insurance; other states do not. If a closing protection letter constitutes insurance, suits to recover under a closing protection letter may be subject to any applicable state law that allows an insured to recover its attorneys' fees if the insured successfully sues the insurer to establish policy coverage.

VI. RECOUPMENT AND SUBROGATION

Closing protection letters provide that if the title insurer reimburses a. lender for a loss covered by the letter, the insurer shall be subrogated to the rights and remedies that would have been available to the lender if the insurer had not paid the loss.[128] Presumably, title insurers should have no difficulty in enforcing a right of subrogation against a dishonest settlement agent. If the title insurer has reimbursed the lender for a settlement agent's theft, the title insurer's right to recover the loss from the settlement agent is unquestionable.

Enforcing subrogation rights becomes more difficult when title insurers attempt to recover from parties who are innocent of any wrongdoing in connection with the closing or who have not been unjustly enriched. Courts understand that when a title insurer issues a closing protection letter, the company is undertaking risks voluntarily in order to promote its business, and they realize that title insurers generally exercise at least some degree of supervision over settlement agents covered by closing protection letters. In these circumstances, the courts have accorded little sympathy to title insurers that seek to recover losses under closing protection letters from innocent third parties. Recoupment and subrogation cases are likely to succeed only if the defendant has been unjustly enriched or if the defendant has participated in the misconduct that caused the title insurer's loss.

In *Lawyers Title Insurance Corp. v. Edmar Construction Co.*[129] a dishonest settlement attorney misappropriated loan funds intended to pay off a second mortgage that the seller had placed on the property. The title insurer

128. See ALTA Closing Protection Letter, at 1-2 of 4. Conditions and Exclusions ¶ C.
129. 294 A.2d 865 (D.C. 1972).

paid off the second mortgage to satisfy a closing protection letter claim filed by the purchaser's lender, and then sued the seller based on the theory of subrogation. The court denied recovery because, as between the seller and the title insurer, there was no wrongdoer and hence no equitable basis for shifting the loss. The court looked on the title insurer as a "volunteer" because the insurer had voluntarily provided closing protection service to promote the company's title insurance business.[130]

The title insurer in *American Title Insurance Co. v. Burke & Herbert Bank & Trust Co.*[131] reimbursed the lender for loan funds stolen by a settlement agent, and then sought to recover the loss from the settlement agent's bank, which failed to return the settlement agent's bad checks for closing proceeds prior to the bank's midnight deadline for dishonoring checks. The court held that the title insurer could not recover as assignee of the checks because the title insurer took the checks with knowledge that they had been returned for insufficient funds. The court also held that the title insurer could not recover under the doctrine of equitable subrogation because equities favoring the title insurer were less than those in favor of the bank. Regarding the latter ruling, the court noted that if the bank had dishonored the checks, as it should have done, the title insurer would have been obligated to reimburse the payees of the checks for the losses resulting from the settlement agent's embezzlement.[132]

In *Clients' Security Fund v. Security Title & Guaranty Co.,*[133] the companion case to *Sears,*[134] the title insurer paid a closing protection letter claim filed by a lender in a refinancing transaction and then brought a subrogation suit against the borrower to recover the loss. The court ruled against the title insurer on two grounds: (1) under *Sears*, the title insurance company would be liable to the borrower even in the absence of a closing protection letter; and (2) the title insurer's subrogation claim would fail because the title insurer stood in the shoes of the lender, and, as between the lender and the borrower, the lender should bear the loss because the lender had greater control over the settlement attorney. The court rested its decision also on the lack of any equitable ground for shifting the loss from the title insurer to the borrower, noting that although the title insurer provided the lender with "protection against attorney defalcation without cost other than the premium paid by [the borrower]," the title insurer "neither offered that protection to [the borrower] nor informed [him] that the risk of attorney defalcation was his to bear."[135]

130. *Edmar Constr. Co. ,* 294 A.2d at 868.
131. 813 F. Supp. 423 (E.D. Va. 1993).
132. *Herbert*, 813 F. Supp. At 430.
133. 634 A.2d 90 (N.J. 1993)
134. Sears Mortgage Corp. v. Rose, 634 A.2d 74 (N.J. 1993).
135. *Clients' Sec. Fund,* 634 A.2d at 95.

VII. CONCLUSION

Closing protection letters facilitate real estate transactions by protecting lenders against the risk of entrusting loan funds or documents to settlement: agents with whom the lenders are unfamiliar. Without closing protection. letters, lenders would need to adopt more cumbersome procedures, as in. New York, to control the risk of theft or misconduct by the settlement agents who close mortgage loans. An overwhelming majority of courts have held that, in the absence of a closing protection letter, a title insurer would have no liability for a settlement agent's fraud or dishonesty in connection with a mortgage loan closing.

Title insurers issue closing protection letters, at no additional charge in most states, to promote title insurance business through issuing agents and approved attorneys. The letters take the form of indemnity agreements that become effective only when a lender entrusts loan funds or documents to a settlement agent. A title insurer's obligation under a closing protection letter is conditioned on the lender designating the insurer as the source of title insurance for a mortgage loan transaction, but is not conditioned on the ultimate issuance of a title insurance policy.

The 1987 *ALTA* form of closing protection letter has brought a considerable measure of standardization to the manner in which closing protection letters are used and to the terms of closing protection letter coverage. However, variations remain, perhaps the most significant being the Regulatory form used in states that regard the 1987 ALTA form as exceeding a title insurance company's authority to insure titles. ALTA closing protection letters protect only the original lender and, if the lender's borrower is a purchaser of a one to four family residence, the purchaser. Closing protection letters, unlike lenders' title insurance policies, provide no protection to an assignee of a mortgage loan. Whether a closing protection letter constitutes insurance depends on the law of each particular state.

The 1987 ALTA closing protection letter covers risks that are substantially different from the risks covered by an ALTA loan policy of title insurance, although there is some overlap. Once an ALTA policy has been issued to the lender, the policy's integration clause comes into play, and the policy supersedes the closing protection letter as to risks covered by the policy. The closing protection letter may nevertheless continue in effect as to any risks covered by the closing protection letter that are not covered by the policy. These kinds of risks include the risk of nontitle-related losses caused by a settlement agent's fraudulent or dishonest conduct in handling a lender's funds or documents. However, the Regulatory form of closing protection letter provides no such extra coverage after the policy has been issued.

The likely trend in the law will be for greater regulation of closing protection letters, not less. State legislatures concerned with protecting home

purchasers from dishonest escrow agents may follow Arizona's lead by requiring title insurance companies to disclose the availability of closing protection letters and the risk of loss that a consumer faces if he or she does not obtain a closing protection letter. State insurance regulators, concerned with statutory limitations on the business of title insurance, have begun limiting the scope of closing protection that title insurers may offer. These converging forces are likely to result in the issuance of more closing protection letters, but with reduced coverage.