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The Title Insurance Law Journal

ALTA
American Land Title Association

Title Insurance

Title Clearance Does Not Require Lawsuit; Possession Exception Negates Duty to Defend Adverse Possession Claim

Main Street Ltd. Partners v. Commonwealth Land Title Ins. Co., 2024 WL 2152176 (Wash.App.) (unpublished).

The Washington Appeals Court has affirmed a decision holding that a title insurer was not required to file an action to confirm the insured's title, after a title examiner affirmed that the insured owned the interests identified in the policy. Further, the court held that the parties in possession exception negates a duty to defend a claim of adverse possession affecting some of the insured parcel.

Main Street Ltd. Partners purchased a bar and restaurant in Vancouver in 1994. Commonwealth Land Title issued a policy to Main Street insuring the parcel. Main Street received a half interest in, and an easement for ingress, light, and air across, a five-foot strip of land. Main Street rented the building to a nightclub. The club used the strip for garbage access and as a second fire exit.

Clark County Public Transportation Benefit Area Authority, known as C-Tran, was the owner of the other half interest in the strip. Until 2015, the court says, both owners used the strip without conflict.

Then, however, C-Tran blocked use of the strip and claimed to be its exclusive owner. C-Tran started building on the strip. The City of Vancouver shut down the nightclub because it no longer had a second exit.

However, the court noted, "C-Tran did not take any legal action to establish title to the Disputed Property during this dispute."

In 2016, Main Street submitted a claim to Commonwealth. It asked the insurer to prove its ownership rights in the strip. Commonwealth accepted the claim to the extent that title to the strip might not be vested in the insured. The insurer retained counsel to represent the insured's interests "to establish vesting in" the strip. Commonwealth sent another letter to Main Street, reaffirming acceptance of the claim. That letter said that Commonwealth had authorized the insured's counsel to file an action.

However, no complaint was filed. Commonwealth prudently examined the

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The Title Insurance Law Newsletter, which is distributed electronically each month by the American Land Title Association (ALTA), reports on cases addressing title insurance coverage, class actions and regulatory enforcement, escrow and closing duties, agent/underwriter disputes, conveyancing law, and RESPA and TILA compliance and violations.

This publication provides helpful information for title agents, approved attorneys, underwriters, claim administrators and attorneys who practice in title insurance defense work or conveyancing disputes.

J. Bushnell Nielsen serves as editor. Please submit news and guest columns to *bnielsen@reinhartlaw.com*.

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real estate records again, and determined that Main Street held record title to the half interest insured in the policy. Commonwealth also verified that finding by "retaining an independent title examiner expert, who confirmed that title was properly vested in Main Street." On that basis, Commonwealth informed Main Street that it had no further obligation at that time.

As an accommodation, Commonwealth offered to have the insurer-retained counsel attend and represent Main Street if it decided to mediate with C-Tran. However, Commonwealth "specifically reminded Main Street" that, if it chose to sue, it would need to retain its own counsel. The insurer "maintained that it had no further obligations to Main Street unless and until C-Tran filed an action to divest Main Street of the half fee title to the Disputed Property."

In 2018, Main Street retained its own counsel and sued C-Tran to quiet title, and to seek money under various claims, including inverse condemnation. C-Tran counterclaimed for quiet title and adverse possession.

Main Street tendered the defense of C-Tran's counterclaims to Commonwealth. Commonwealth accepted defense of the quiet title claim, to the extent that C-Tran claimed Main Street did not have a half interest in the strip based on recorded conveyances. It declined to defend the adverse possession claim because the policy contained a parties in possession exception. The lawyer retained by Commonwealth defended Main Street in coordination with the insured's separate counsel. The case was settled, and C-Tran paid some money to Main Street.

This decision emanated from the lawsuit that Main Street brought against Commonwealth for breach of contract, bad faith and alleged unfair business practices under the Washington Insurance Fair Conduct Act. Main Street's main argument was that Commonwealth breached a duty to defend title. Commonwealth moved for summary judgment. In support of that motion, Commonwealth submitted a declaration from your editor, "a professional with 41 years of work experience in and related to the land title insurance industry." Main Street moved to strike the declaration. The court denied the motion and considered the declaration. The court granted Commonwealth summary judgment, dismissing all of Main Street's claims.

The appeals court affirmed. Main Street made two main arguments: that Commonwealth had a duty to establish title through litigation, and that it had a duty to defend the adverse possession counterclaim.

Main Street's argued that, when C-Tran claimed to be the sole owner of the disputed land, that invoked a *duty* under Condition 4(b) of this 1992 version policy to establish title through a lawsuit. Main Street argued that, when Commonwealth retained counsel for Main Street to establish title, that was tantamount to an agreement to file suit. That was the predicate for Main Street's claim that Commonwealth did not establish title diligently.

Commonwealth responded that the policy did not require it to prosecute a lawsuit against C-Tran when counsel was hired, because there was no challenge to title at that time. Also, it said, establishing title is a right, not a duty. Further, it said that it had no duty to take further affirmative action after it confirmed that record title was as insured. The court adopted Commonwealth's reading of the policy, saying:

> Commonwealth maintains that because it discovered that title was vested in Main Street as insured, Commonwealth had no further duty to Main Street, as no other party had sought to legally extinguish Main Street's title at that point. Commonwealth is correct. The language of the policy is unambiguous. Moreover, because Commonwealth had not yet initiated litigation when it discontinued its coverage of Main Street's claim, Commonwealth did not owe any further duty to Main Street. Specifically, Commonwealth did not owe a duty to "establish title" before C-Tran brought suit to legally extinguish Main Street's title.
>
> Under the commonly understood definitions of litigation as used in statute, court rules, and case law, initiating litigation generally requires a service of process or filing of complaint. Here, Commonwealth's retained counsel for Main Street had not filed a complaint or initiated any proceedings prior to Commonwealth's discontinuation of coverage. Thus, Commonwealth did not exercise its right to litigate and therefore had no

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> duty to pursue litigation diligently.

The court also agreed with Commonwealth that what it did established title. It quoted Conditions 4(b) and 9(a). It said that these two terms, "when read together, outline some of the rights Commonwealth has under the policy and when those rights can be considered fully performed, if exercised." Condition 4(b) states that the insurer may file a lawsuit or "do any other act which in its opinion may be necessary or desirable to establish the title… ." Condition 9(a) says that the insurer has performed its obligations when it establishes title "by any method, including litigation… ." The court said:

> Additionally, under the express language of the policy, Commonwealth did establish title. As defined in both section 4(b) and the cover page of the policy, Commonwealth's duties only arise to cover loss or damage "sustained or incurred by the insured by reason of: ... [t]itle to the estate or interest described in [the policy] being vested other than as stated therein," and Commonwealth has the right to undertake any actions necessary to establish title as insured. … When Commonwealth discovered that title was vested as insured and confirmed the same with a title examiner expert, it was acting within its rights under the policy. Additionally, by doing so, Commonwealth did "establish title" under the policy because it established that title was vested as described in the policy. Without any pending legal action against that title, there was no defect in title.
>
> Similarly, under the express language of section 9(a) of the policy, when Commonwealth confirmed that title was vested as insured, it had fully performed any obligations to Main Street and had no further duties to Main Street at that time. Until C-Tran counterclaimed for quiet title, there was no defect in title and, therefore, the policy was not implicated. Thus, Commonwealth had no duty to establish title… .

The court also agreed with Commonwealth that the parties in possession exception negated a duty to defend Main Street against C-Tran's adverse possession claim. It began by noting that, in Washington, to analyze the duty to defend, the insurer considers only the four corners of the insurance contract plus the four corners of the underlying complaint, together described as the "eight corners." The insurer "may not give itself the benefit of the doubt in determining whether a claim is covered, nor may it rely on an equivocal interpretation of the law when denying its duty to defend a claim." There is a duty to defend a claim that is "conceivably covered." *Webb v. USAA Cas. Ins. Co.*, 12 Wn. App. 2d 433, 445-46, 457 P.3d 1258 (2020).

Exception 2 of the policy negated coverage for "[a]ny facts, rights, interests or claims which are not shown by the public records but which could be ascertained by an inspection of the land or which may be asserted by persons in possession, or claiming to be in possession thereof." Main Street argued that the exception did not apply because C-Tran's rights came from an instrument recorded in 1984. Commonwealth replied that C-Tran's adverse possession claim was in the alternative to its record title claim, and that insurers routinely apply the possession exception to negate a duty to defend adverse possession claims.

Again, the court sided with the insurer, saying:

> Here, C-Tran's counterclaim for adverse possession was pleaded in the alternative to its quiet title claim. Additionally, C-Tran based its adverse possession claim solely on the contention that "[its] operation of a transit center [across the Disputed Property from 1984 through 2004] constituted exclusive, actual and uninterrupted, open and notorious, and hostile possession for over ten years." … C-Tran did not premise its adverse possession claim on any allegation related to title or the public record. According to the specific language of Exception 2 in the policy, this claim would constitute a claim "not shown by the public records but ... which may be asserted by persons in possession, or claiming to be in possession thereof."
> …
>
> Per the express language of the policy, C-Tran's adverse possession claim would not be subject to Commonwealth's duty to defend. This is further supported by the fact that Washington courts often hold that when similar exceptions to Exception 2 exist in a title insurance policy, adverse possession claims do not give rise to the insurer's duty to defend. See, e.g., *Dickins v. Stiles*, 81 Wn. App. 670, 916 P.2d 435 (1996); *Haley v. Hume*, 10 Wn. App. 2d 484, 448 P.3d 803 (2019). As such, Commonwealth had no duty to defend against the adverse possession claim, and the trial court did not err in granting summary judgment and dismissing Main Street's claims as they relate to C-Tran's adverse possession counterclaim.

Commonwealth was very ably represented by Wendy E. Lyon and Jon S. Bogdanov of Fox Rothschild LLP in Seattle.

Title Insurance

Insurance Lawsuit Stayed Until Road Status Decided

Munden v. Stewart Title Guar. Co., ___ F.Supp.3d ___, 2024 WL 2272679 (D. Idaho 2024) (permanent citation not yet available).

An Idaho court has affirmed its decision to stay a title insurance coverage suit about access and a road until the ownership of the road at issue is resolved in a separate action.

Prior decisions in this lawsuit were reported in the May 2020, October 2021 and

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January 2024 issues. The case is about the use of Upper Garden Creek Road. The Mundens own two large parcels, on either side of the road. Bannock County claims to own the road, and has adopted ordinances restricting its use. In winter, the only traffic allowed by the ordinance is by snowmobile.

In its most recent decision, found at 2023 WL 4902006, the court stayed the federal coverage action until there is a ruling in a state lawsuit about whether or not the road is public. In the 2023 decision, the court made a number of other rulings that would appear to limit the case to diminution in value, rejecting the insureds' claims that the insurer should pay for buildings they built on other property and like theories.

Chicago Title has paid diminution in value already, based on an appraisal report that used the premise that the road is public. It moved for reconsideration on the stay, saying that, no matter what the outcome of the road case, "the Mundens' loss in property value has already been assumed, appraised, and paid." The court began by insisting that:

> While Chicago Title is free to proceed on its assumptions about ownership, the Court needs a clear determination regarding ownership to ascertain whether Chicago Title owes the Mundens any amount at all.

It also said that conducting a trial about insurance policy loss before road ownership was decided might lead to an after-the-fact attack on the loss amount judgment, saying:

> Ensuring consistency between this and other cases requires that the ownership of the road be determined before proceeding. Imagine, for instance, that the Court moved forward in these proceedings under the assumption that the County owned the road and determined that Chicago Title was obligated to compensate the Mundens for the resultant diminution in their property value. Imagine that in a related case, the Court later determined that the Mundens—and not the County—actually owned the road. Those rulings would be fundamentally inconsistent with and contradictory to one another. Further, Chicago Title might then seek appeal or reconsideration of the Court's earlier decision in this matter, requesting reversal of the Court's determination that it was obligated to compensate the Mundens. Thus, principles of judicial economy and consistency demand that the Court put first things first and uphold the MDO staying these proceedings until the status of Upper Garden Creek Road is determined.

The court concluded by recognizing that "Chicago Title's point is well taken, and the Court understands that it is eager to move this case forward." However, Judge Nye said that he was "optimistic that the status of the road will be resolved soon," because the Mundens had recently petitioned him to make that determination, in a new federal action against the county.

Your editor finds this decision fascinating, because it may be the first to directly address the issue of how to resolve a policy claim when the title issue is not yet decided. It is more common for the roles to be reversed, with the insured seeking a coverage or loss determination without a decision on the validity of the title matter. The court's reasoning would be useful to the insurer in that situation.

Matthew R. Cleverley of Fidelity National Law Group in Seattle, represents Chicago Title.

Title Insurance

Ohio Court Affirms That Policy Arbitration Provision Not Enforceable Because "Not Usual"

Fucci v. Bowser, ___ F.Supp.3d ___, 2024 WL 2076855 (D. Utah 2024) (permanent citation not yet available).

A Utah federal district judge has affirmed the ruling that a title insurer may not enforce the ALTA policy arbitration provision in Ohio, because Florida made a wording change in that provision. The magistrate judge ruling that the district court affirmed was reported in the December 2023 issue and is found at 2023 WL 6391506.

This case involved Christopher Fucci and many others, who bought tenancy in common interests in real estate located in Florida and Ohio as replacement properties in 1031 exchanges. The sellers were Rockwell Debt Free Properties Inc. and related entities. The escrows were conducted by First American Title's Salt Lake City office.

First American had already issued owner's policies to Rockwell for each property. As Fucci and the others bought fractional interests in the properties, First American issued endorsements naming them as additional insureds as to their fractional shares.

The projects failed. The plaintiffs now claim that First American "promised the invested money would be held in escrow by First American and disbursements would be made only for land purchases and for incremental completion of event centers which were to be built on the properties." Instead, the plaintiffs say, First American immediately disbursed the money to Rockwell, which spent the money and performed no construction.

The plaintiffs sued in Utah federal court, naming a number of defendants. This decision concerns First American's motion to compel arbitration. The magistrate judge had denied the motion based on new information raised by the plaintiffs at the hearing. The court allowed considerable additional briefing. This court affirmed the ruling nonetheless.

First American first argued that it had the right to arbitrate as to all of the plaintiffs under the purchase contracts. The court again gave a lengthy discussion of that demand. It found that First

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American was not a party to the purchase contracts or an intended beneficiary of them. The court also held that the Rockwell bankruptcy trustee had the right to waive the insurer's right to arbitrate. Equitable estoppel did not apply, it ruled.

The purchase contracts also said that agents of the parties had the right to arbitrate. The court somehow found that an escrow agent is not an agent. It said:

> As the magistrate judge noted, Plaintiffs' description of FA Defendants as being the "escrow agent" or "closing agent" describes FA Defendants' role in the transaction, not the legal status of a common-law agent. "An escrow holder is not a common-law agent because the holder does not act subject to the control of the parties to the escrow agreement." Here, the PSAs do not provide for either party having the right to control the FA Defendants. Because the FA Defendants have not shown that Rockwell had the right to control the FA Defendants, they have not established an agency relationship under Ohio or Florida law.

The statement the court quoted came from Black's Law Dictionary.

The court also affirmed that First American was not entitled to assert the policy arbitration provision as to the Ohio plaintiffs. The fulcrum of this claim was that the insureds did not see the arbitration provision until after closing. It is of course standard that the insured gets the policy after closing. However, in this case each insured became so by an endorsement to a 2006 form policy that had already issued to Rockwell.

This court held that the arbitration provision in the ALTA policy is not "usual and customary," so it could not be enforced because the insureds did not see it before closing. The court again focused on *Henderson v. Lawyers Title Ins. Co.*, 108 Ohio St.3d 265, 843 N.E.2d 152 (Ohio 2006), which said merely that title insurance policies "are presumed to have intended that the ensuring policy would include the usual and customary provisions found in similar title insurance policies." If the policy delivered after closing contains the "usual and customary" terms, it simply reflects the parties' mutual intent. This court said that *Henderson* stands for the reverse rule, that a title insurance policy that deviates from "usual and customary terms" must be delivered to the insured "prior to closing in order for nonstandard terms to be binding."

The court rejected First American's first argument, that the *Henderson* rule applies only to residential deals, and that sophisticated insureds and their lawyers already know the terms of a standard ALTA policy. These insureds were buying TIC interests as the replacement legs of tax-deferred exchanges, making them sophisticated. The court never addressed the sophisticated insured doctrine. It said that, because the *policy* was a "standard" version, *Henderson* applied.

Next, the court rejected First American's statement that arbitration provisions have been usual and customary terms in Ohio title insurance policies for decades, including the policies approved for usage since *Henderson*. First American introduced evidence of the successive ALTA policy forms. The court began by saying that "[j]ust because the 2006 ALTA Owner's Policy includes 'an arbitration clause' does not mean that all arbitration clauses are usual and customary in the industry." It then decided the ALTA language is not customary in Ohio by only comparing the standard ALTA provision to the version promulgated in Florida, which is unique:

> For example, unlike First American's policies for the Ohio transactions, which allow for a unilateral demand for arbitration, the policies First American issued for the Florida transactions provide that "arbitration ... may be demanded if agreed to by both the Company and the Insured at the time of a controversy or claim." As the magistrate judge explained, such an arbitration clause does not add any additional rights beyond what would be permitted in its absence. Thus, because one party can unilaterally avoid arbitration, the Florida agreements effectively contain no arbitration agreement.

The court faulted the insurer for not explaining "what the 2006 ALTA Owner's Policy's arbitration clause entailed." It said that, without that information, "the court cannot determine what the usual and customary terms are and whether the Ohio policies conformed to those terms."

This decision is highly frustrating to read. However, the ALTA Forms Committee has long since remedied the issue. The 2021 version of the ALTA commitment contains optional Condition 11, which states that the policy "contains an arbitration clause," recites its essential term and states that a "Proposed Insured may review a copy of the arbitration rules at http://www.alta.org/arbitration." The 2006 version of the ALTA commitment contained a similar provision.

Title Insurance

No Mechanic Lien Coverage Under Covered Risks 10 and 12

NorthMarq Finance, LLC v. Fidelity Nat'l Title Ins. Co., ___ F.Supp.3d ___, 2024 WL 2027009 (D.Colo. 2024) (permanent citation not yet available).

Covered Risks 10 and 12 provide no coverage for mechanics' liens and lien foreclosures filed after the date of policy, particularly when the policy contains ALTA 32 and 33 endorsements.

NorthMarq Finance arranged a loan to build a senior living community in Littleton, Colorado. The loan was HUD-insured. Fidelity National Title was selected to issue a policy and serve as construction disburser. When Fidelity learned that certain work had been done before closing that might cause broken priority, it agreed to give mechanic lien coverage through ALTA 32 and 33

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endorsements. NorthMarq and HUD accepted that offer. Fidelity issued a 2006 version ALTA loan policy with an ALTA 32.1-06 endorsement.

The project progressed for some time. Draw requests were approved by a HUD inspector. The general contractor, Petra, was paid by Fidelity. With each paid draw, Fidelity issued an ALTA 33-06 endorsement. The final ALTA 33 endorsement extended the Date of Coverage to Nov. 18, 2019.

None of the draws submitted after that payment were funded. Petra terminated the contract. Beginning in March 2020, subcontractors and Petra recorded mechanics' liens. Four of the subcontractors filed lien foreclosure actions, claiming priority over the insured deed of trust. Petra filed cross claims, and also claimed that its lien had priority.

NorthMarq tendered a claim for a defense and indemnification to Fidelity. The insurer denied the claim. NorthMarq sued Fidelity under the policy. The reader is entitled to know that your editor is an expert witness for Fidelity in the case.

This decision granted Fidelity's early motion for partial summary judgment. The court addressed NorthMarq's claims that the policy provided coverage for the mechanics' liens under Covered Risk 10, for priority of the insured mortgage over other liens; Covered Risk 11, which concerns mechanics' liens; and Covered Risk 12, which indemnifies for the invalidity or unenforceability of a mortgage assignment shown in Schedule A. The decision does not address coverage under the ALTA 32.1 and 33 endorsements.

The court first dispensed with Covered Risk 11. It noted that the ALTA 32.1 endorsement explicitly deleted Covered Risk 11(a), which is the coverage for work to be done in the future that is financed by the loan secured by the insured mortgage. The court said that NorthMarq did not dispute Fidelity's assertion that Covered Risk 11(b) does not apply, or "meaningfully address coverage under Covered Risk 11." The court found no coverage under that Covered Risk.

NorthMarq did argue that coverage existed under Covered Risks 10 and 12. The Court disagreed. It said:

> The Policy insures Covered Risks 10 and 12 "as of Date of Policy," which is July 31, 2017. … Exclusion 3(d) excludes from coverage "loss or damage, costs, attorneys' fees, or expenses" arising because of defects, liens, encumbrances, adverse claims, or other matters "attaching or created subsequent to Date of Policy" and specifies that the exclusion does not modify coverage provided under Covered Risk 11, 13, or 14. … By specifying in Exclusion 3(d) which Covered Risks are not modified, the Policy makes clear that any Covered Risk not enumerated is modified by Exclusion 3(d); this includes Covered Risks 10 and 12.

The court buttressed its ruling with the fact that the ALTA 33 endorsements extending the Date of Coverage for indemnification against mechanics' liens would be superfluous if Covered Risk 10 already gave that coverage, saying:

> The parties deleted Covered Risk 11(a) and replaced it with the Endorsement, which even Fidelity agrees provides at least some post-policy mechanics' lien coverage… . The Endorsement provides that it does not modify any of the terms and provisions of the Policy or extend the Date of Policy, and to the extent a Policy provision or other endorsement is inconsistent with an express provision of the Endorsement, "this endorsement controls." … [S]ee *Blackhawk-Cent. City Sanitation Dist. v. Am. Guarantee & Liab. Ins. Co.*, 214 F.3d 1183, 1190 (10th Cir. 2000) ("The general rule provides that when a conflict in an insurance contract arises between provisions contained in the body of the policy and provisions contained in an endorsement to that policy, the endorsement provisions prevail." (quoting *Simon v. Shelter Gen. Ins. Co.*, 842 P.2d 236, 241 (Colo. 1992)).)

The Court also found "highly persuasive" the decision of *Hall CA-NV, L.L.C. v. Old Republic Nat'l Title Ins. Co.*, 990 F.3d 933 (5th Cir. 2021). In that situation, the insurer gave mechanic lien coverage by ALTA 32 and 33 endorsements, but the insured lender claimed mechanic lien coverage under Covered Risks 2 and 10. The Fifth Circuit rejected the claim, saying that such an interpretation would render the more specific coverage as mere extra baggage. This Court applied *Hall*:

> As in *Hall*, to adopt NorthMarq's interpretation of the contract and find coverage under Covered Risks 10 and 12 would render the parties' decision to delete Covered Risk 11(a) and agree to the Endorsement meaningless. Such a finding would contravene Colorado law, which requires the Court to read an insurance policy as a whole and construe the policy to harmonize all provisions and render none meaningless. *Godin & Baity*, 2020 WL 5076764, at *6 (D. Colo. Aug. 27, 2020) ("The Court must interpret the Policy 'in its entirety with the end in view of seeking to harmonize and to give effect to all provisions so that none will be rendered meaningless.' " (quoting *Copper Mountain, Inc. v. Indus. Sys., Inc.*, 208 P.3d 692, 697 (Colo. 2009))).

The Court also rejected NorthMarq's assertions that the policy is ambiguous. The first claim was that a reference to the policy in the ALTA 32.1-06 endorsement meant that the terms Date of Policy and Date of Coverage were identical. The Court said:

> First, NorthMarq argues that because the introductory words in Section 4 of the Endorsement say "This policy," "Fidelity extended the time period of coverage under 'this Policy,' not merely the Endorsement." … Not so. Covered Risks 10 and 12 are tied to the Date of Policy, not the Date of Coverage. … And, while Section 4 undisputedly uses the phrase "this policy," the Endorsement

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provides that it does not modify any of the terms and provisions of the Policy and controls to the extent it is inconsistent with another provision of the Policy. … Further, the ALTA 33 Endorsements did not modify the Date of Policy, merely the Date of Coverage, and therefore, they do not affect the period covered by Covered Risks 10 and 12.

NorthMarq also argued that the ALTA 32.1 is incompatible with Exclusion 3(d). The court rejected that argument also, saying:

NorthMarq highlights language in Section 2 [of the endorsement] that states that "[t]he insurance ... added by Section 3 of this endorsement is subject to the exclusions in Section 4 of this endorsement and the Exclusions from Coverage in the Policy, the provisions of the Conditions, and the exceptions contained in Schedule B." … According to NorthMarq, "by its terms, the prospective coverage Fidelity contends is offered only by the Endorsement would be completely eliminated by Exclusion 3(d), resulting in unenforceable illusory coverage." … Again, NorthMarq misreads the last paragraph of the Endorsement, which provides that to the extent a provision of the Policy "is inconsistent with an express provision of this endorsement, this endorsement controls." … No ambiguity or conflict exist.

NorthMarq does not dispute that the Mechanics' Liens were recorded and the Lien Suits filed after the Date of Policy. … Therefore, any potential coverage available under the Policy for the Claim may be found only under the Endorsement.

Escrow Matters

Trustee of Deed of Trust Still Ensnarled in Borrower Action

Carpenter v. Fawcett, ___ F.Supp.3d ___, 2024 WL 2250078 (W.D.Wash. 2024) (permanent citation not yet available).

Although the title insurer trustee on a deed of trust has since resigned, the court has refused to dismiss the borrowers' claim against it under the Washington Consumer Protection Act.

The Washington court dismissed a quiet title claim against First American based on proof that the insurer has resigned of record as trustee under the deed of trust. The court relied on RCW 61.24.010(2), which says that the "resignation of the trustee shall become effective upon recording of the notice of resignation in each county in which the deed of trust is recorded." Because First American was no longer the trustee, the Court had no basis to order it to reconvey the deed of trust, as the borrowers wish.

However, the court refused to dismiss the borrowers' Consumer Protection Act claim. The court had dismissed the claim under that act under a prior version of the complaint, because the borrowers admitted that they had not paid off the loan and thus First American had no duty to reconvey.

In this iteration of the complaint, the borrowers said that First American's "unfair act" was that it allegedly failed to respond to the claim that the deed of trust should be "corrected" because it was in an amount greater than the loan principal. The court did not make clear what power First American would have possessed to "correct" the deed of trust.

The court noted that Washington law imposes a duty on the trustee in favor of the borrower. RCW 61.24.010(4) says that the trustee "has a duty of good faith toward the borrower, beneficiary, and grantor." *Patrick v. Wells Fargo Bank, N.A.*, 196 Wn. App. 398, 412, 385 P.3d 165 (2016), said that a trustee may be liable under Consumer Protection Act for a breach of this duty of good faith toward the borrower. Also; *Lyons v. U.S. Bank, N.A.* 181 Wn.2d 775, 784–89, 336 P.3d 1142 (2014), refused to grant summary judgment when the plaintiff alleged that the trustee violated its duty of good faith and there were fact issues about whether the trustee investigated the status of the loan and acted impartially between the note holder and mortgagee.

The fact that Washington imposes a duty on the trustee running in favor of the borrower is clearly a possible liability.

Escrow Matters

Recent Fed Reserve Rule Sets Check 21 Fraud Loss Rules

63rd & Morgan Currency Exchange, Inc. v. Citibank, N.A., ___ F.Supp.3d ___, 2024 WL 245189 (N.D. Ill. 2024); Garfield-Dan Ryan Currency Exchange, Inc. v. Citibank, N.A., ___ F.Supp.3d ___, 2024 WL 2052077 (N.D.Ill. 2024).

Two recent Illinois decisions illustrate how a Federal Reserve regulation affects which party suffers the loss in Check 21 fraud. The decisions do not involve title insurers, but are instructive.

This article recites the facts in the *Garfield-Dan Ryan* case. Dyonnesha Woolfolk took a photo of an $840 check payable to him and deposited it in his account at Citibank using a Check 21 application.

Then Woolfolk went to a check-cashing business, Garfield-Dan Ryan, and presented the original of the same check. That business accepted the check and paid him. Then Garfield took a second image of the check to deposit it into its account at Republic Bank of Chicago. The version of the check sent by Republic was dishonored because the obligation had already been paid. Garfield replaced the money in its account under an agreement with Republic.

Garfield sued Citibank for the money. The court dismissed

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the action, based largely on the reasoning in *63rd & Morgan Currency Exchange*, which involved very similar facts. The courts said that the question of who must suffer this kind of loss is set by Section 229.34(f) of Regulation CC, issued by the Federal Reserve to implement the Check 21 Act.

The Check 21 Act is that modern wonder that allows an image of a check to be deposited, which is known as check truncation. The Fed added § 229.34(f) to deal with situations in which customers inadvertently or fraudulently use banks' "remote deposit capture" services to deposit the same check more than once. Under the regulation, the loser is not supposed to be based on which bank submits the check first. Rather, § 229.34(f) "creates a remedy to shift such losses onto the bank that created the risk of loss by allowing its customers to deposit checks via remote deposit capture." That remedy is an indemnity from the one bank to the other. The court said:

> As the Board noted in its rulemaking on § 229.34(f), this allocation of risk is based on the assumption that "the bank that accepts a check via remote deposit capture is in the best position to address the actions of its own customer and to guard against the subsequent deposit of the paper check." 82 Fed. Reg. at 27,568.

Given this regulation, one might expect the court to have held that Citibank must pay Garfield. It did not. The Fed regulations provide an indemnity from one bank to another. Garfield is not a bank. Garfield argued that it stood in its bank's shoes after reimbursing it, by equitable subrogation. The court rejected that argument, labeling equitable subrogation a "troublesomely vague" doctrine.

Further, the court said that Republic Bank could not seek indemnity from Citibank, because the regulation gives the indemnity right only to a bank that accepts the "original check." In this case, the check-cashing company truncated the original check, and apparently did not deliver the original to Republic Bank.

This is an interesting pair of decisions on yet another technological innovation that fraudsters have bent to their own purposes. Most escrow officers and closers know not to honor a request from a seller who asks for proceeds by check and later returns, asking that the money be wired instead. The seller may have truncated the check in the interim, causing the title company to pay twice.

Escrow Matters

Wire Transfer Fraud Warnings Do Not Automatically Exonerate

Lanahan v. Regions Bank, ___ *F.Supp.3d* ___, 2024 WL 2060138 (M.D.Tenn. 2024) (permanent citation not yet available).

Getting the buyers' signatures on a wire transfer fraud warning notice does not entitle the real estate agent to be dismissed from an action to replace the stolen money. The decision also provides a useful discussion of proximate cause and last clear chance.

Jamey and Lori Lanahan contracted to buy a home not far from Nashville. The real estate agent was Pamela King of Gary A. Ashton, Inc. doing business as The Ashton Real Estate Group of Re/Max Advantage. King had the Lanahans sign a notice warning them of the risk of wire transfer fraud. The closing services would be by Tennessee Title Services LLC.

The Lanahans now allege that, in their dealings with King and Tennessee Title:

> the email addresses for various real estate professionals were hacked or otherwise intercepted by an unknown fraudster. The fraudster monitored emails between Plaintiffs, Ashton, Pamela King, and Tennessee Title. The fraudster impersonated various real estate professionals by creating email addresses and digital signatures that were nearly identical to the real estate professionals' legitimate email addresses and signatures. The fraudster strategically participated in various email conversations to cause confusion, misdirection, and otherwise manipulate the course of Plaintiffs' transaction to the fraudster's advantage.

The result was that the Lanahans got two sets of wiring instructions, one genuine and the other a fraud, both purportedly from Tennessee Title.

On March 14, 2022, Mr. Lanahan met in person with Marithza Ellison at a Regions Bank branch office to arrange the wire transfer to the seller's bank account at JPMorgan Chase. He filled out Regions' wire transfer request form and gave it to her. It appears he inserted the fraudster's account information on that form.

However, Ellison did not initiate the wire transfer because she saw that Mr. Lanahan was holding two sets of wire instructions. She explained that wire transfer fraud is a risk. Both Ellison and Lanahan tried calling Emily Kornbau of Tennessee Title to learn which set was genuine. They could not reach her.

Lanahan told Ellison that he would drive to Tennessee Title to find out which wiring instructions were genuine. Lanahan told Ellison not to wire the money until he had that confirmation and had called her. She agreed.

After Lanahan left, Ellison got a call from someone who claimed to be with Tennessee Title, telling her to send the money to the fraudster's account. Ellison later described the voice as "male with … a heavy foreign accent." She did not ask for his name, "did not attempt to verify his identity, and did not ask Mr. Lanahan or anyone else to confirm the caller's legitimacy." Based solely on that call, Ellison wired the purchase money of almost $450,000 to the fraudster's account at JPMorgan.

Hours later, Ellison called Lanahan to say that she had wired the money. Lanahan was surprised. Ellison "reassured him that it was fine," the court says. Lanahan told Tennessee Title that the purchase money had been sent. That company told the seller title company that the purchase was closed. The Lanahans moved into the home.

Several days later, Tennessee Title called the Lanahans to

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ask where they had sent the money. They contacted Regions, and were told that "a cyber-criminal had become involved in the transaction and may have stolen their funds."

Regions said it would attempt to recover the money. The Lanahans filed a complaint with the Internet Crime Complaint Center. They recovered about $11,000. Then they pulled money from their retirement savings to pay for the house a second time.

The Lanahans sued Regions Bank, Re/MAX and Pamela King. All defendants filed motions to dismiss. The court dismissed only the negligence claim against the bank, and none of the claims against the real estate agent and broker.

The claim the court dismissed was the Lanahans' negligence claim against Regions. The UCC preempts negligence claims about action taken in the processing of a wire transfer request. The Lanahans tried very hard to show that the negligence was outside of the process of making a wire transfer. The court disagreed, and dismissed the claim as being preempted by Article 4A of the UCC. However, the court clearly stated that it was not dismissing the claim for violation of Article 4A.

Re/MAX sought dismissal because it warned the Lanahans of the risk of wire transfer fraud in a "disclaimer" that King made them sign. The broker also said that the Lanahans had made only conclusory assertions about Re/MAX's purported breach of a duty of care. The claimed duty was to "implement and maintain cybersecurity systems and protocols sufficient to ensure the security of its electronic correspondence with Plaintiffs and exchange of other sensitive transaction-related information," as the brokerage put it.

Re/MAX also argued that Regions made the mistake, and the broker "had no duty to implement cybersecurity protocols to protect the communications of its independent contractors."

The court said that the complaint alleged enough for the claims against Re/MAX and King to survive. Then it launched into an extended discussion of Tennessee law on causation. The court said:

> What Re/MAX really appears to be attempting to argue is that Marithza Ellison's negligence in sending an unauthorized wire was an intervening, superseding cause that interrupted the causal chain and relieved Re/MAX of any possible liability. … Re/MAX certainly has a solid basis for arguing that Ellison's acts of noticing the dueling wire instructions, accepting Mr. Lanahan's timely cancellation of the wire order, but then transmitting the wire anyway, without authorization, constitute intervening cause.

The court said this issue would have to be sorted out later.

King also sought dismissal. The court did not reach her claim that the purchase and sale agreement included a waiver of the right to sue for this claim. However, the court rejected King's second claim, that she did not have a duty to protect the Lanahans:

> Second, as for whether King had a duty to protect the plaintiffs from criminal acts by third parties, the Tennessee Supreme Court has held that businesses have a duty to take reasonable measures to protect their customers from foreseeable criminal attacks. *McClung v. Delta Square Ltd. P'ship*, 937 S.W.2d 891, 899–900 (Tenn. 1996). While the criminal attack at issue in McClung was physical in nature, the court sees no impediment to extending the principle to protection from foreseeable cybercrime. And there appears to be no dispute in this case that attempts by cybercriminals to insert themselves into the wire transfer process in real estate transactions are foreseeable.

The court repeated that, at this early stage, it would not answer the question of whether or not "simply warning the plaintiffs about the possibility of cybercrime satisfied that duty."

Your editor believes that everyone can agree that the effect of this fraud is devastating, and that the public would be well served if someone beyond the real estate industry were to regularly inform people about it.

Escrow Matters

Lawsuit on Texas Escrow and Purchase Sent to New York

Sommery Lot 2 LP v. Sommery Round Rock TX, LLC, ___ F.Supp.3d ___, 2024 WL 2045704 (W.D.Tex. 2024) (permanent citation not yet available).

A magistrate judge has recommended that a Texas action about Texas property be sent to New York, because the buyer filed suit there first.

Sommery Lot 2 LP contracted to sell property in Williamson County, Texas to Sommery Round Rock TX LLC. Round Rock deposited the initial earnest money of $2,500,000 with an escrow agent, presumably a company in Texas. After some time, seller Lot 2 announced that closing must occur on a certain date that was 45 days out.

Lot 2 showed up at the closing table. Buyer Round Rock did not. Both parties then demanded the earnest money from the escrow agent.

Lot 2 sued in Texas several days after the closing date. However, Round Rock had filed suit in New York the week before closing. Round Rock moved to have the Texas case transferred to New York. The magistrate recommended transfer under the first-to-file rule. That rule is "animated by the concern to avoid the waste of duplication," inconsistent rulings and "to avoid piecemeal resolution of issues that call for a uniform result." The judge cited *Kolb v. Conifer Value-Based Care, LLC*, 2023 WL 8244293 (N.D. Tex. Nov. 27, 2023), which in turn quoted from *Cadle Co. v. Whataburger of Alice, Inc.*, 174 F.3d 599, 603 (5th Cir. 1999).

Seller Lot 2 argued that Round Rock's New York lawsuit fell in the anticipatory filing exception to the rule, having been filed even before

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the scheduled closing date. The judge considered that issue, but ruled that the New York action was not an anticipatory filing.

The significance of this decision to escrow companies lies in the fact that, if buyer and seller get in an argument, that case may be decided in a place very far away from the escrow company's office.

Conveyance News

Title Not Made Good By Offer of Insurance

771 Allison Court LLC v. Sirianni, 2024 WL 2232983 (N.J.A.D.) (unpublished).

One title insurer's willingness to insure against a right of first refusal, for a premium, did not make title marketable in the state required by a purchase contract.

Harvey Berk owned a house in Moorestown, N.J. In 2010, he recorded a deed with an onerous right of first refusal, that said that the property had to be offered for sale to first him, then his daughter, then his son, then a family trust if a future owner wished to sell. The right specifically said that it would run with the land. A corrective deed said that the right "shall only be extinguished by the death of his children, Haley Berk and Daniel Berk."

Berk sold the home in 2019 to 771 Allison Court LLC, an entity controlled by Jeff Schneider, "an experienced licensed New Jersey realtor and luxury home builder." The lawyer who represented both buyer and seller warned that the right could create difficulties in selling the property in the future. Schneider spent about a million dollars renovating the home.

Schneider put the home on the market. Nicholas and Brett Sirianni signed a purchase contract. The court said that, "during the listing period, the ROFR was not disclosed" to them. The contract required delivery of title that was "free from all claims or rights of others… ." A restriction violation would not be a reason to reject title "as long as the title company insures Buyer against loss at regular rates."

The title searcher located the right of first refusal. The seller produced two successive versions of a waiver of the right. The title company said that it found a "single underwriter" who was "willing to entertain the idea" of an additional policy endorsement for an additional fee, "above and beyond the normal rate for title insurance." The Siriannis cancelled the purchase contract rather than pursue the insurance idea.

The court said that the Siriannis bought another house. Schneider sold the Berk house to someone else after disclosing the right of first refusal. The court said that "the ROFR was excepted from coverage in the new buyer's title insurance documents."

This lawsuit was brought by Schneider's entity against the Siriannis, about the purchase contract. Schneider argued that the right of first refusal was a "restriction," but not a use restriction, so the contract did not give the buyers a right to terminate the contract. The trial court held that the right was a "restriction on the alienability of the Property." As a result, the seller's failure to "eliminate" the right confirmed that it was unable to deliver title "free and clear from all claims… ."

The appeals court affirmed. It began by noting that a right of first refusal is not a garden variety restriction. It restricts the owner's right to "dispose freely of [the] property by compelling [the seller] to offer it first to the party who has the first right to buy." *St. George's Dragons, LP v. Newport Real Est. Grp., LLC*, 407 N.J. Super. 464, 482 (App. Div. 2009), quoting *Mazzeo v. Kartman*, 234 N.J. Super. 223, 229 (App. Div. 1989)). The court further noted that this particular right was "structured" to apply to every conveyance of the property until the death of Berk's children.

The court said further that the issue of whether or not "the fifty-dollar additional fee to insure the ROFR raised the available title insurance above 'regular rates'" was moot. It said that, "even if the additional fee was not above regular market rates, plaintiff was unable to convey marketable title."

This decision highlights two fundamental title issues. A right of first refusal is very dangerous because, if exercised, the holder supplants the contract purchaser. Also, a title insurer's willingness to consider insuring over an interest is very different from the removal of that right.