CADWALADER

Title (Coverage) Not Available

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Two recent decisions concerning title insurance illustrate that an insured's negligence can result in an exclusion from coverage and that title insurers generally do not owe a fiduciary duty to their insureds.

In *First Nat'l Bank of Izard Cnty. v. Old Republic Nat'l Title Ins. Co.*, the Court of Appeals of Arkansas (the "Court") denied a rehearing where a title insurance company refused to defend an insured bank and denied the insured bank's claim for coverage where another party held an interest superior to the bank's mortgage in connection with a foreclosure. The Court affirmed the circuit court's order of summary judgment in favor of Old Republic National Title Insurance Company ("Old Republic") on appeal by First National Bank of Izard County (the "Bank").[1]

In connection with the dissolution of a partnership, two partners, Helen and George Bartmess (each individually, a "Bartmess" and collectively, the "Bartmesses"), sold their business interests to John Hardy ("Hardy"). Hardy obtained a loan from the Bank to effectuate the purchase.[2] One of the assets transferred in the sale was a 377-acre tract of land (the "Phillips Corner Property"). The terms of the sale were set forth in two documents: (1) an LLC Membership Interest Purchase Agreement (the "Purchase Agreement"), which set forth the terms and conditions of the sale and (2) a Memorandum of LLC Membership Interest Purchase Agreement Affecting Real Estate and Rights Therein (the "Memorandum").[3] The Purchase Agreement contained a provision that created a reversionary interest in the Phillips Corner Property back to the Bartmesses under certain instances of noncompliance. While the Memorandum did not explicitly disclose the reversionary interest in the Phillips Corner Property, it indicated that: (1) the document affected rights in real estate; (2) the Memorandum would be filed in the mortgage and conveyance records for Izard County, Arkansas; and (3) a legal description of the Phillips Corner Property was attached to the Memorandum.[4]

The Bank made two loans to Hardy related to the Phillips Corner Property to facilitate the transaction, and the Bank was on notice of the purpose of the Memorandum.[5] The Bank issued a $55,000 loan (the "55k Loan") secured by a mortgage on the Phillips Corner Property dated February 12, 2009, and, five months later, a $155,000 loan (the "155k Loan"; together with the 55k Loan, the "Loans") also secured by a mortgage on the Phillips Corner Property.[6] Old Republic issued separate title insurance policies to the Bank insuring that (the policies for the Loans, collectively referred to as the "Policies"), which Policies insured the Bank's mortgage liens were superior to other claims on the Phillips Corner Property.[7] In connection with the closing of the 55k Loan, an employee of the Bank who served as witness and notary took possession of the documents, including the Memorandum and the Bank's mortgages, and mailed them to the county clerk for recording. The employee included a note that stated "record in this order" on the first document and placed a number on the following documents to indicate the correct order for recording.[8] On February 23, 2009, the county clerk recorded the documents, filing the Memorandum four minutes before the Bank's mortgages encumbering the Phillips Corner Property. The clerk returned the recorded documents to the Bank employee, who did not check to confirm they were recorded in the correct order. The Bank closed on the 155k Loan on July 8, 2009, and Old Republic issued a title policy in connection with the closing, which indicated the only prior lien on the Phillips Corner Property was the 55k Loan without reference to the Memorandum.[9] Hardy went into default on the Loans in 2015, and the Bank initiated a foreclosure action. Bartmess asserted a superior interest in the Phillips Corner Property pursuant to the Memorandum.

Old Republic refused to defend the Bank and denied the Bank's coverage under the Policies. The Bank subsequently filed suit against Old Republic, claiming: (1) breach of the Policies for failure to provide coverage; (2) failure to defend the Bank in the foreclosure; and (3) failure to pay the Bank's damages due to the loss of its security interest in the Phillips Corner Property.[10] The Policies contained a provision that certain matters were expressly excluded from coverage and Old Republic would not be responsible for loss or damages, costs, attorneys' fees or expenses arising therefrom, including for "[d]efects, liens, encumbrances, adverse claims or other matters: (a) created, suffered, assumed, or agreed to by the Insured Claimant" (the "3(a) Exclusion").[11]

Old Republic asserted in its motion for summary judgment that: (1) the terms of the Memorandum and the LLC Purchase Agreement were disclosed to the Bank and were in the Bank's possession prior to closing, and (2) the Bank's handling of the documents for recording resulted in the Memorandum being recorded ahead of the mortgages. The circuit court determined that Old Republic correctly applied the 3(a) Exclusion because the Bank "created, suffered, assumed or agreed to" the title defects, where the term "suffered" is equivalent with "permitted" and "implies a power in the insured to prohibit the act giving rise to the defect."[12] The Court held that the circuit court did not err in concluding that willful intent on the part of the Bank was not required for the 3(a) Exclusion to apply where the Bank had the power to prohibit the Memorandum from having priority over its mortgages, thus Old Republic properly denied coverage under the Policies.[13]

Similarly, in *Murphy v. Commonwealth Land Title Insurance Company*, the United States District Court for the Eastern District of New York (the "District Court") granted summary judgment in favor of the defendant insurance companies,

Fidelity National Financial, Inc. ("FNF") and Commonwealth Land Title Insurance Company ("Commonwealth"), a wholly owned subsidiary of FNF, where Commonwealth and FNF properly denied the plaintiff's claim for coverage because it fell under certain exclusions to the plaintiff's title policy.[14] The plaintiff, Edward Murphy ("Murphy"), financed the purchase of a home in Sag Harbor, New York (the "Sag Harbor Property"), which was secured by a mortgage in favor of Washington Mutual Bank ("WAMU") as lender.[15] Commonwealth issued a title policy to Murphy in connection with the purchase of the Sag Harbor Property, subject to certain exclusions, including: (1) loss or damage arising by reason of the mortgage; (2) all encumbrances attached to or created subsequent to the date of the policy (June 4, 2002); and (3) all matters "created, suffered, assumed or agreed to" by the insured (collectively, the "Exclusions").[16]

WAMU initiated foreclosure proceedings against Murphy after he failed to pay the mortgage. A foreclosure judgment (the "2008 Foreclosure") was entered and in November 2008, the Sag Harbor Property was thereafter sold to JPMorgan Chase Bank ("JPMC"), as successor to WAMU. In October 2009, JPMC sold the Sag Harbor Property to an individual (the "Purchaser") who was issued a title insurance policy from Fidelity National Title Insurance Company ("FNTIC"), which, like Commonwealth, is a wholly owned subsidiary of defendant FNF.[17]

The appellate court set aside the 2008 Foreclosure judgment due to improper service of process in April 2015. Murphy then sued JPMC and the Purchaser seeking damages for wrongful foreclosure and an order vacating the Purchaser's deed to the Sag Harbor Property (the "2016 Action"). FNTIC accepted the Purchaser's claim for coverage related to the 2016 Action, while Commonwealth denied coverage to Murphy related to the 2016 Action because the suit arose out of the default on his mortgage, which commenced after the date of the title insurance policy.[18] In February 2019, the Suffolk County Supreme Court found that the Purchaser was a bona fide purchaser and dismissed Murphy's claim for wrongful foreclosure.[19]

Murphy brought suit against Commonwealth and FNF alleging breach of contract, violations of the New York General Business Law (the "GBL") § 349, and breach of fiduciary duty. The District Court denied the breach of contract claim, finding that Commonwealth properly declined coverage under the Exclusions because Murphy brought the foreclosure upon himself and the mortgage was subsequent to the deed and title insured by Murphy's policy.[20] Further, because there was no breach of contract, the District Court concluded that a conflict of interest which would require appointment of independent counsel pursuant to GBL § 349 did not exist, as Commonwealth had no obligation to defend Murphy in the 2016 Action in the first instance.[21] Likewise, the District Court held that Murphy's breach of fiduciary duty claim failed as a matter of law, because (1) insurance companies do not owe a fiduciary duty to their insureds absent a special relationship, (2) a special relationship could exist between an insurance company and its insured where an insurer has an obligation to defend the insured in a liability claim; however, here the District Court ruled that Commonwealth had no obligation to defend Murphy in the 2016 Action by virtue of the Exclusions, and (3) Murphy failed to allege any special circumstances that would give rise to a fiduciary relationship.[22]

These decisions are potentially pervasive, extending exclusions from title insurance coverage to more than just intentional actions but to negligent actions as well.

While certain circumstances may invoke different obligations, *Murphy v. Commonwealth Land Title Ins. Co.* also demonstrates the standard scope of the relationship between insurer and insured. The outcomes of these decisions stress the significance of an insured's understanding of the limitations to their coverage and how their actions, intentional or unintentional, may impact such limitations. Of note, in addition, is that it is more typical for title insurance companies to take possession of and be responsible for the recordation of documents at closing. The decision in the Old Republic case probably would have been different if the title company was the party responsible for recordation. While local customs and practices vary throughout the country, parties should be wary of the impact that assuming responsibility for recordation may have on their coverage.

[1] *First Nat'l Bank of Izard Cnty. v. Old Republic Nat'l Title Ins. Co.*, 2022 Ark. App. 440, 1 (2022), reh'g denied (Dec. 14, 2022)

[2] *First Nat'l Bank of Izard Cnty*. at 2.

[3] Id.

[4] Id.

[5] Id. at 10.

[6] Id. at 3.

[7] *First Nat'l Bank of Izard Cnty*. at 3.

[8] *First Nat'l Bank of Izard Cnty*. at 4.

[9] Id.

[10] Id. at 5.

[11] *First Nat'l Bank of Izard Cnty*. at 9.

[12] Id. at 9.

[13] Id. at 10-11.

[14] *Murphy v. Commonwealth Land Title Ins. Co.*, 2022 WL 3347223 (E.D.N.Y. Aug. 12, 2022).

[15] *Murphy v. Commonwealth Land Title Ins. Co.*, at 1.

[16] Id.

[17] Id.

[18] Id.

[19] Id. at 2.

[20] *Murphy v. Commonwealth Land Title Ins. Co.*, at 3.

[21] *Murphy v. Commonwealth Land Title Ins. Co.*, at 3.

[22] Id. at 4.