EXTRA-CONTRACTUAL LIABILITY FOR AGENTS AND UNDERWRITERS PART TWO

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This article is Part Two of two articles. Part One appeared in the Committee's Summer, 2014 newslettter. Mr. Price is a partner at Cantey Hangar, LLP's Dallas, Texas office which he founded in 1990. His practice area includes litigation and appellate work in business law and real estate. This article was originally presented at the Title Insurance Litigation Committee's Spring, 2014 meeting in Las Vegas, Nevada. He can be reached at: RPrice@canteyhanger.com, Telephone: (214) 978-4118..

BAD FAITH

The failure to timely investigate, and/or defend, or pay a claim based upon an issued policy commonly brings with it a claim for "bad faith claims handling." In Texas, this idea derives from the Texas Insurance Code (Section 541.060) and common law concepts, and is often included in cases where Deceptive Trade Practices are alleged.

Texas courts have struggled with a "safe harbor" from bad faith claims. For a while, we thought an expert's opinion would suffice; but cases based on egregious facts took that away.[1] The Texas Supreme Court says an insurer cannot insulate itself from bad faith liability by investigating a claim in a manner calculated to construct a pre-textual basis for denial.[2,3]

Some Texas cases provide a "safe harbor" for Texas title insurers. The Plaintiff must show that liability under the policy is "reasonably clear."[4] If the alleged defect which is the basis for the claim is not reasonably clear or has been cured, then no bad faith can exist.

In addition, no bad faith claim is presented if the title insurer did not breach the coverage provisions of the policy.[5] This case was reversed and remanded by the Fifth Circuit.[6] The opinion of the appellate court (in the first reported case using the terminology) affirmed dismissal of "extra-contractual" claims, including those based on bad faith. In addition, the court appears to recognize a safe-harbor for title insurers. Essentially, the decision indicates that, where the policy is ambiguous and/or the insurer denied coverage based on a reasonable interpretation of the policy, there is no bad faith.

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To date, the author has been unable to locate any Texas case which holds that "good faith/bad faith" principles are applicable to the process of underwriting the policy. One Texas case has held that no cause of action can be maintained for breach of the duty of good faith and fair dealing in the underwriting portion of an insurance transaction.[9] (This appears to have been the first time that this particular theory was ruled upon by an appellate court in a published decision).

A recent Federal Court case provides a good example of conflating of title insurance and non-title insurance cases.[10] A South Carolina federal court held that breach

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1 *State Farm Lloyds v. Nicolau*, 951 S.W.2d 444 (Tex. 1997).

2 *Nicolau*, 951 S.W.2d at 448.

3 *State Farm Fire & Cas. Co. v. Simmons*, 963 S.W.2d 42 (Tex. 1998).

4 *Chicago Title Ins. Co. v. Alford*, 3 S.W.3d 164 (Tex.App.-Eastland 1999, writ denied).

5 *Fidelity National Title Ins. Co. v. Doubletree Partners*, 866 F.Supp 2d 604 (E.D. Texas, 2011).

6 739 F.3d848 (Fifth Circuit, 2014).

7 *Transamerica Title Ins. Co. v. San Benito Bank and Trust Co.*, 756 S.W.2d 772 (Tex.App.-Corpus Christi, set aside by the Texas Supreme Court pursuant to settlement, 773 S.W.2d 13).

8 *Premier Tierra Holdings v. Ticor Title Ins. of Florida*, 2011 WL 2313200.

9 *Commonwealth Lloyds Insurance Company v. Downs*, 853 S.W.2d 104 (Tex.App.-Ft.Worth 1993, writ denied).

EXTRA-CONTRACTUAL...

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of the duty to defend creates liability for a variety of extra-contractual, consequential damages (including lost profits, lost rents, construction delays, relocation of improvements, etc.). Hopefully this case can be classified as a trial court's results-oriented misinterpretation of the law (which will not be reversed because the case was settled prior to trial).

SEARCH AND EXAMINATION STATUTES

In those states which have adopted a statutory framework for the title insurance industry, some have provisions in their statutes requiring that the policy be issued only after a search and examination of title in accordance with "sound underwriting practices".[11] The definition of "sound underwriting practices" is not defined by any statute reviewed by this author. This is the kind of situation which a creative plaintiff's lawyer can utilize to effectively advocate for a change in the law.

As an example, some cases have used search and examination statutes to modify existing law. In each of these cases, the statutory requirement of search and examination was used to create a cause of action based on the theory that the statute created a duty to the insured to conduct a thorough examination, and the insured has a cause of action based on breach of that duty. These cases effectively resulted in a change of these states from "duty to indemnify" status to "duty to discover and disclose" status.

In contrast, other courts have held the statute does not create a duty to discover and disclose.[12] The Texas appellate court determined that the search and examination statute was not intended to create a "private cause of action." Perhaps the most puzzling aspect of this issue is that the Ruiz case from New Mexico reaches an opposite conclusion based on a statute which is identical to the Texas statute. The author has been informed that the New Mexico statute was copied from the Texas statute.

The courts which have agreed with the Becker decision include Culp Const. Co. v. Buildmart Mall, 795 P.2d 650 (Utah 1990), Walker v. Anderson-Oliver Title Ins. Agency, Inc., 309 P.3d 267 (Utah App. – 2013) and Walter Rogge, Inc. v. Chelsea Title & Guaranty Co., 562 A.2d 208, rev'd 603 A.2d 557 (N.J. 1992). As a result, it is believed that the current weight of authority holds that the search and exam statutes were not intended to create an independent cause of action.

10 *First American Title Insurance Company v. Columbia Harbison*, (2013 WL 1501702) (U.S. Dist. Ct. – South Carolina, Columbia Division).

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State	Statute	Search & Exam Statute Interpreted
Alaska	21.66.170	826 P.2d 1126
Arizona	20-1567	310 P.3d 23
Colorado	10-11-106	
Connecticut	38a-407	
Florida	627.7845(1)	
Hawaii	431:20-113	
Idaho	41-2708	
Missouri	381.071	
Montana	33-25-214	661 P.2d 12
Nevada	692A.220	
New Hampshire	416-A:6	
New Jersey	17:46B-9	582 A.2d 208
New Mexico	59A-30-11	850 P.2d 972
North Carolina	58-26-1	
North Dakota	26.1-20-05	
Ohio	3953.07	
Oklahoma	5001(c)	
Pennsylvania	910-7	
Tennessee	56-35-129	
Texas	9.34 Ins. Code	930 S.W.2d 748
Utah	31A-20-110	795 P.2d 650
Wyoming	26-23-308	

12 *Stewart Title Guaranty Co. v. Becker*, 930 S.W.2d 748 (Tex.App.-Corpus Christi 1996, err. dism'd).

In those states where search and examination statutes are interpreted as creating a duty to discover and disclose title defects, the underwriting process will come under more legal scrutiny. These search and examination statutes were meant to protect the financial integrity of the title insurance underwriter and the local title companies. However, the Ruiz and Bank of California cases are examples of incorrect reasoning which changes the focus, and threatens that integrity.

CRIMINAL LIABILITY ISSUES

Many times, closers see themselves as a mere conduit without liability for any fraudulent or criminal acts which are part of the closing. Criminal convictions of closers and brokers give ample reason for a closer to avoid dicey situations.

For example, a closer in the Eastern District of Texas (Sherman Division) was convicted on multiple counts of fraud on an FDIC insured institution. The closer was charged with assisting a builder in completing a "double contract" closing. The facts indicated the closer was aware of the double contract and was funding the seller's note proceeds (lender's money) to the seller/builder prior to getting funding from the buyers. (The seller would take his check to the bank and provide the buyers with down payment funds.).

An example of a reported case reveals a real estate agent being convicted of a federal crime when $60,000.00 cash (brought in a brown paper bag) was used by a drug dealer as part of the purchase price for the property in a "double contract."[13] In this case, it was admitted that the large amount of cash was presumed to be drug money. Therefore, the jury convicted the agent on the federal crime of "money laundering" and "engaging in a transaction in criminally derived property." The court stated (at page 856):

> (The accused) cannot be convicted on what she objectively should have known. However this requirement is softened by the doctrine of "willful blindness."

This concept of "willful blindness" means to deliberately close your eyes to that which would otherwise be obvious.

ADMINISTRATIVE ISSUES

Some states and the federal government have prosecuted title insurers and title agents using administrative agency regulatory authority. The Office of Comptroller of the Currency (OCC), has authority under 12 U.S.C. 1813 to pursue enforcement actions. These can include large fines and "debarment" from transactions involving federally insured institutions.

In addition, State regulators can revoke licenses for intentionally wrongful acts.[14] A review of internet-posted administrative actions reveals license suspensions/revocations in various states occurring for a variety of wrongful acts. These include:

1) Notarizing false documents and forged signatures,
2) Knowingly facilitating fraudulent transactions,
3) Unsafe financial condition of the agent, and
4) Theft of funds.

SUMMARY

Extra-contractual liability must be examined on a state-by-state basis. The courts of some states continue to recognize (and expand) extra-contractual liability. The "contract liability" states continue to see litigation designed to circumvent prior law. The "abstractor liability" states may also see the use of the statutes to create a form of strict liability. Modifying the terminology in commitments has occurred, and legislative intervention has been necessary (in California and Arizona). Closers, agents, and underwriters have exposure to civil claims, criminal prosecution, and administrative enforcement actions when participating in questionable transactions.

13 *U.S.A. v. Campbell*, 777 F.Supp 1259, (aff'd in part, rev'd in part 977 F.2d 854).

14 *All American Title Agency LLC v. Department of Financial and Professional Regulation*, 2013 WL377974, 2013 Ill. App (1st) 113400 (Ill. App. 1st Dist. 2013).