RESIDENTIAL REAL ESTATE

Risk Management, Risk Trends and Tips for Real Estate Lawyers

Jennifer M. Guerra, Esq.
Carlock, Copeland & Stair, LLP
191 Peachtree Street
Suite 3600
Atlanta, Georgia 30303
(404) 221-2313

jguerra@carlockcopeland.com

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MALPRACTICE CLAIMS AND LITIGATION

I. TYPICAL PARTIES AND CLAIMS RESOLUTION

Parties	Potential Contributor	Potential Plaintiff
Lender	✓	✓
Borrower	✓	✓
Title Insurer	✓	✓
Title Checker	✓	
Seller	✓	✓
Downstream Lender		✓
Real Estate Broker or Agent	✓	
Loan Broker	✓	
Appraiser	✓	
Closing Attorney	✓	✓
Title Agent	✓	✓

Many real estate closing claims can be resolved for less than litigation costs by working with other players to either "fix" the problem or solicit contributions from various friendly or unfriendly parties.

LENDER

The lender is typically the closing attorney's client. When transactions go awry, it is the lender who is most likely to suffer the consequences. Typically, the title insurer, the closing attorney and the title agent have some sort of established business relationship, which can facilitate working together for the common good – a resolution of the claim. The lender is best-

suited to bring a claim against the lawyer, as the attorney-client relationship is clearly established between lender and attorney.

BORROWER

In Georgia, the borrower is typically not the client of the attorney. Most real estate attorneys will have borrowers sign a form reflecting that the borrower understands he is not the attorney's client. Despite this, however, many borrowers actually believe that the closing attorney is their attorney. When something goes awry with their transaction (for example, if they did not get good title to the property they thought they bought), they will frequently bring a claim against the lawyer. Usually the attorney can prevail in suits brought by borrowers.

If the lawyer volunteers to undertake services for the borrower, which occasionally happens, the borrower becomes a client and the attorney becomes liable for professional negligence. Georgia, and most other states, have tort liability for negligent misrepresentation. Thus, if a borrower can show that he reasonably relied upon work done by the closing attorney and the lawyer was aware of that reliance, liability might arise.

Borrowers are increasingly suing lawyers when property is foreclosed or threatened with foreclosure. Distressed borrowers often look to professionals involved in due diligence and the closing attorney in an effort to hang onto the property or help pay to get out from under a deficiency judgment. These claims may be entirely frivolous but can consume a great deal of time and money in defense.

TITLE INSURER

The title insurer insures the lender's or the borrower's interest in the real property and is often the key player in real estate litigation. In Georgia, the closing attorney is usually the agent for the title insurance company. Thus, when a loan secured by real estate closes, the attorney is wearing two hats: (1) attorney for the lender; (2) agent for the title insurance company.

Attorneys who close real estate loans frequently have very close and cordial relationships with their title insurance company or companies. Most title insurers require a minimum volume and thus most closing attorneys have, at most, a couple of title insurers for whom they can write title insurance. The title insurance agreement between the title insurer and the attorney places contractual obligations upon the attorney and leaves him liable for mistakes he makes at closing. However, the closing attorneys who sell the title insurance are the lifeblood of the title insurance company. Title insurers are frequently very protective of their closing attorneys (although less so today than in the past) and may contribute more than might make sense otherwise in order to maintain good relationships with their agent.

Many lenders require Insured Closing Letters before they will allow an attorney to close a loan for them. Insured Closing Letters are issued by a title insurance company and protect against actual damages resulting from fraud or mistakes at the closing. These Insured Closing Letters are often misplaced and, thus, when a big claim arises, there is a scramble as the lender seeks to find the Insured Closing Letter that may be the answer to all its problems.

Because the title agent has such a close relationship with the title insurance company, you will often find that, when a problem arises, the agent will immediately hand his file over to the title insurer. While this can be troubling, working closely with the title insurance company will often yield the best result in any event.

If an agent loses the ability to write title insurance, he is essentially out of business.

TITLE CHECKER

In Georgia, attorneys go to the courthouse or send someone to the courthouse to check the Superior Court records to determine who owns the property and if there are any liens or other encumbrances affecting the property. There are many third-party providers who spend almost their entire professional lives in the courthouse receiving requests for title searches and then providing such a search to a closing lawyer, who then relies on it. If these title checkers have their own Errors and Omissions insurance, that can provide substantial assets toward resolving a problem claim. Unfortunately, because the profit margins are so tight in this business, many such title checkers do not carry Errors and Omissions insurance, and almost all are judgment-proof.

SELLER

The seller usually has no claim after a transaction closes. On the other hand, if the seller takes back any purchase money financing in lieu of cash at the sale of the property, the closing attorney may represent the seller, who is also a lender. If the debt taken back by the seller is the second mortgage, the closing attorney may close a purchase money mortgage made by the seller as an "accommodation." This obviously muddies the water as to whom the attorney represents and can result in additional problems, if a claim is made.

The seller generally gives an affidavit to the closing attorney and title insurer at closing, verifying that there are no other liens on the property. If a claim arises because of liens which were not discovered by the closing attorney, the closing attorney and the title insurer may have a

claim back against the seller for breach of the representations in his affidavit. Likewise, at least in Georgia, the sellers generally give a warranty deed to the purchaser warranting title. Thus, if the purchaser has a title problem, he can often be directed to the seller, who if not judgment-proof, can be forced to make good on the title warranty.

DOWNSTREAM LENDER/DISTRESSED DEBT BUYER

In recent years, often a problem with a loan transaction may be discovered by someone other than the original lender. That party may or may not be the attorney's client. A downstream lender would have to either pursue a closing attorney on a negligent misrepresentation theory or upon the theory that it received an assignment of the right to sue the lawyer from the original lender.[1] Often, however, the original lender may have a buy-back obligation and must buy the loan back from the downstream lender if there is a problem. Thus, the fact that the loan has been resold, or perhaps even foreclosed upon, may not protect the closing attorney from liability.

APPRAISER

Real estate lenders will always require that an appraisal of the property be performed prior to loan closings. The appraisal is obtained by the lender and, typically, the attorney has no involvement with the appraisal other than perhaps to deliver a copy to the parties at closing. Fraudulent appraisals may be the most frequent indication of real estate fraud. But, increasingly, challenges are being raised as to whether title defects or restrictions were adequately considered and conveyed to appraisers when such restrictions allegedly impact the value of the land.

[1] As of 2013, legal malpractice claims are non-assignable by law.

Commercial appraisers are more established and more likely to have insurance, which could contribute toward the resolution of a claim but, they frequently are reluctant to contribute and will challenge liability.

II. MISSED LIEN OPTIONS

A. Pitch it to the Title Insurance Company

1. They may come back at us.
2. Attorney may be worried about that relationship.
3. May not be any title insurance.

B. Pitch it to the Bank

1. May not be any.
2. Attorney may be worried about that relationship.
3. Loan may be current.
4. Equitable subrogation?

C. Buy Missed Lien and Pursue Seller

1. Claim on note, affidavit and deed. Fraud?
2. Seller may flee or be judgment proof.

D. Buy Loan You Closed and Pursue Seller

1. Claim on note, affidavit.
2. Fraud?
3. Seller may flee or be judgment proof.
4. Purchaser may get a claim too.

E. Just Let it Go on Foreclosure

1. May liquidate damages.

2. May aggravate relations with other parties.

F. Special Relationships Between Closing Lawyers and Title Insurers

Title insurers are in a desperate battle with their competitors for closing lawyers who generate lots of premiums. They can be more understanding and negotiable during the claims handling process in an effort to keep the agents selling their policies. Often creative dispute resolution techniques are available to good agents including reducing the size of the claim against the agent if the agent will, in turn, promise to sell a certain volume of policies in the upcoming year or if the agent threatens to abandon the title insurer if they pursue the claim.

III. WHEN THE DEAL DOESN'T MATCH THE PAPER

Large commercial real estate transactions frequently have moving targets and pieces falling together as closing approaches. Banks, unfortunately often use generic closing instructions, loan conditions and other paper that may contradict how everyone "understands" the deal is being closed. When the deal later fails, the "understanding" shared by all is forgotten, misremembered, or someone simply reneges. The phone calls, notes, and e-mails conflict with what the official paper says. Who wins? Perhaps not the lawyer.

Lawyers are reluctant to document waivers, modifications, or subsequent oral agreements when they might slow down the deal, create more work, or make it appear as though they are questioning or distrustful of the lender. Alternatively, lawyers are too trustful of lender, borrower, or seller representatives who claim to have worked everything out without the involvement of the lawyer. When a lien does not get released, a payoff does not get made, a

deed does not get cancelled, or a key loan condition is not met, the closing lawyer unfortunately is saddled with liability for whom someone else may be to blame.

IV. REAL ESTATE FRAUD

As the real estate market soured, real estate fraud was exposed and new incidences of real estate fraud decreased as profits evaporated. Unfortunately, as the market improves, new actors and schemes emerge and old ones are resurrected. In large commercial deals, the "flip" is rare but in smaller deals with vacant land purchases, lawyers should keep their eyes open for suspicious transactions.

Lien fraud also remains a risk as construction and development activities restart. Fictitious materialmen liens and second and third security interests help funnel cash out of a transaction. Common or related ownership between payees and the parties in a transaction may not always be evidence of fraud but should raise red flags.

V. DEFALCATION FROM ESCROW

Two ways Closing Attorneys can be involved in defalcation (misappropriation of funds) are: (1) failure to remit premiums due to their title insurer; and (2) failure to properly disburse funds which they held in escrow.

A. FAILURE TO REMIT PREMIUMS

1. How Supposed to Work

a. collect premium at closing

b. subtract agent's portion (40-70%)

c. remit remainder to carrier

d. sometimes have to wait month or two for recording

e. usually remit in bulk

2. Safeguards to Avoid Fraud

a. title insurer gives policies to agent, keeps track of numbers

b. title insurer audits escrow account

c. title agent audits escrow account

3. Problems That Help Hide Fraud

a. Volume business hard to keep track

b. insurers bend over backwards to please agents

c. time lag on records

4. Special Litigation Factors

a. agency agreement usually terrible for agent

b. if employee theft insurer may cut some slack

c. potential RICO

B. FAILURE TO PROPERLY DISBURSE FUNDS AT CLOSING

1. How Supposed to Work

a. lender or purchaser funds sale or loan

b. closing agent disburses payments to seller/borrower/ lienholder as per settlement statement

c. closing statement accurately reflects payments

d. lienholders release liens

e. title policy issues

2. Lien Payoff Problem Plaintiffs

a. seller and purchaser

b. lien holder if they quitclaim in advance

c. lender if their security interest is jeopardized

c. title insurer

3. Safeguards

a. audit by title insurer

b. audit by CPA

4. Problems That Hide Fraud

a. volume

b. time lag

c. failure to recognize SOP not followed

5. Special Litigation Factors

a. usually many many problems

b. potential RICO

c. insured closing protection letter

Claims involving a lawyer's escrow or trust account may also invite ethical claims and bar involvement. Misuse of client funds typically invokes harsh punishment.

RISK MANAGEMENT AND CLAIMS AVOIDANCE

I. INSURANCE AND APPLICATIONS

There are many things I might consider as risks that could affect insurability and rates for a closing lawyer[2].

1. What title insurance companies are you an agent for?
2. Any title insurers decline to take you as an agent or canceled your agency for any reason ever? If so, who and when.
3. Do title insurers audit or examine your escrow account and closing files and, if so, how often and when was this last done?
4. Who balances your escrow account and how often?
5. Who abstracts titles for you and do they have insurance?
6. How often do you remit premiums to the title insurer and who calculates them?
7. Do you use Non-Representation Disclosures?
8. Is your work heavily centered on a few clients?
9. Staff turnover, length of employment.
10. Attorney to staff ratio.
12. Percentage of distressed clients.

When filing new applications or renewals, take care in fully responding to questions regarding claims or potential claims. Failure to disclose a claim (even a frivolous one) could later jeopardize coverage and defense.

[2] Of course I'm not an insurance underwriter so you might ask your own insurer what risks they look at.

II. RECOGNIZE AND ADDRESS THE RISKS

A. Know who your client is.

B. Document your work.

C. Recognize when the facts don't match the paper.

D. Train, supervise and monitor the work of non-lawyers.

E. Don't ignore impaired lawyers (whether mental or physical illness).

F. Carefully monitor the money and those you hire to monitor the money.

III. CLAIM HANDLING

A. Don't ignore the claim.

B. Attempts to cover-up or fix the problem without client knowledge almost always more harmful than helpful.

C. Understand in-house counsel privileges and limitations.

D. Beware of conflicts.

E. Be careful what you agree to or admit to others.

F. Give notice of potential claims and seek out advice and assistance of your carrier or outside counsel.

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