Possible Agency Relationship Between Title Insurers and Closing Attorneys

By Ronald Z. Ahrens

The New Jersey Supreme Court's decision in *New Jersey Lawyers' Fund for Client Protection v. Stewart Title Guaranty Co.*, 203 N.J. 208 (2010), is extremely important to all involved with the New Jersey real estate industry, including attorneys, mortgage lenders, title insurance companies and homeowners, not only because it offers clarification of the circumstances under which a title insurance company may be held liable for the negligent or fraudulent acts of individuals in connection with the closing of a real estate transaction, but because it suggests a deviation from the previous understanding under which some real estate professionals were operating.

In order to fully appreciate the import of *Stewart*, it is helpful to briefly review the New Jersey Supreme Court's earlier holding in *Sears Mortgage Corp. v. Rose*, 134 N.J. 326 (1993). In that case, the Court held that a title insurer was liable to repay the New Jersey Lawyers' Fund for Client Protection for losses sustained as the result of a closing attorney's embezzlement of funds that were to be used to pay off a lien. This was a significant decision because the *Sears* court determined that an agency relationship existed between the closing attorney and the title insurer.

In so doing, the Court noted that "a court must examine the totality of the circumstances to determine whether an agency relationship exist[s]" and it expressly acknowledged that its decision in that case "turn[ed] on the specific relationships between the parties and the roles and responsibilities of the several parties." The Court explained that it found an agency relationship to exist in that case because the closing attorney was an "approved attorney" of the title insurer and, therefore, the company had the ability to control him. The Court further based its finding of agency on its determination that, of all the innocent parties harmed by the attorney's defalcation, the insurance company "was in the best position to prevent the loss created."

The *Sears* decision created confusion for real estate practitioners, however, because the identification of an "agency relationship" was not well-defined by the Court and is not always clear-cut in reality. Many real estate professionals have assumed that a title insurer is automatically liable for the actions of a closing attorney or settlement agent in connection with a real estate closing, believing that, under *Sears*, the title insurer is always responsible for the actions of its closing attorney. Other professionals find that view problematic because it does not accurately reflect the reality of the closing table and title insurance. In particular, it is troubling that *Sears* held a title insurer liable for the actions of an independent contractor closing attorney, a dramatic departure from the long-standing tenet of agency law that principals are not generally liable for the torts of their independent contractors. *See Baldasarre v. Butler*, 132 N.J. 278, 291 (1993). This murky history was the context in which the Court considered the *Stewart* case.

In *Stewart*, the homeowners sold a home and received approximately $325,000 in net proceeds. The closing attorney representing the homeowners in the transaction had previously represented them in other transactions. The homeowners intended to apply the proceeds of the sale to the purchase of a new home, and instructed the closing attorney to disburse $50,000 of the proceeds to them and to hold the balance in his trust account pending the closing on their new home. The closing attorney then embezzled the homeowners' money. Thereafter, the closing attorney ordered title insurance from an agent of Stewart Title Guaranty Company, and subsequently Stewart Title's agent mailed the closing attorney a title insurance commitment. When the homeowners attended the closing on their new home, the closing attorney issued a number of checks from his trust account. The homeowners learned shortly thereafter that the checks issued by the closing attorney had bounced and that he had embezzled the closing funds.

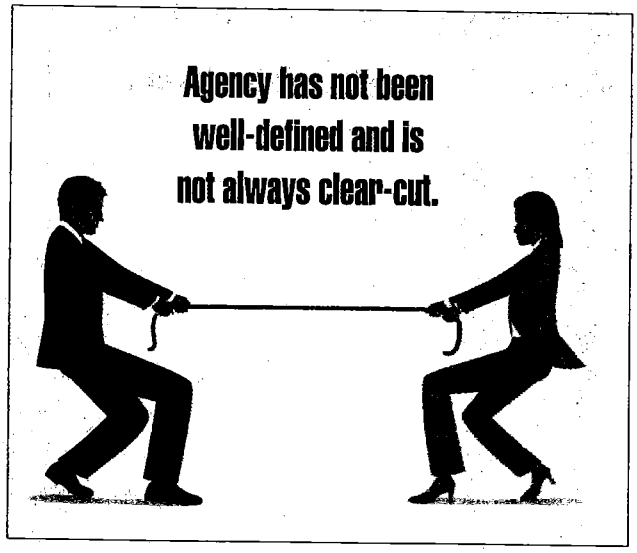
The homeowners sought and received a recovery from the Lawyers' Fund, in exchange for which they assigned their rights and claims to recovery from the closing attorney and third parties to the Lawyers' Fund. The Lawyers' Fund then sued Stewart Title and the title agent seeking to recover its loss. On cross-motions for summary judgment, the trial court found in favor of Stewart Title. The Lawyers' Fund appealed and, remarkably, the Appellate Division reversed. *N.J. Lawyers' Fund for Client Prot. v. Stewart Title Guar. Co.*, 409 N.J. Super. 28 (App. Div. 2009).

Relying on *Sears*, the Appellate Division held that there was an agency relationship between Stewart Title and the closing attorney and, specifically, that a title insurance company "is in the best position to prevent the harm of defalcation, not just at the moment when the theft occurred, but at any time during the various key procedural events leading to the closing of title and beyond." The Supreme Court, however, reversed the Appellate Division's decision. *Stewart*, 203 N.J. at 208.

After summarizing general principles of New Jersey agency law, the Court found that an analysis of the facts of this case made clear that there was no agency relationship between the closing attorney and the title insurance company at the time of his defalcation. The Court held that the homeowners could not have relied on the fact that the closing attorney was a representative of Stewart Title because the attorney took the money before title insurance was ordered. It expressly stated that the circumstances that gave rise to the agency relationship in *Sears* were not present in this case. It also noted that the title insurance company never represented to the homeowners that the attorney had actual or apparent authority to act on its behalf. As a result, the Court held that the title insurer could not be liable for the closing attorney's actions.

The New Jersey Bar Association, recognizing a need for further clarification by the *Stewart* Court, requested as an amicus participant that the Court revisit its decision in *Sears*. The *Stewart* Court expressly declined, however, noting that it would leave a renewed discussion of *Sears* "for another day."

Therefore, we are left with at least two distinct messages from the *Stewart* Court. *Sears* remains the law in New Jersey, but a title insurer will not always be liable for the acts of the closer of a real estate transaction. Because the *Stewart* Court reached the opposite decision, i.e., no liability, than the *Sears* Court, it clarifies that a title insurer should only be found liable for the acts of a closer when the specific facts of the case demonstrate that there was an agency relationship between them. That determination should be based on an individualized analysis of the facts of each case. No one case can be construed as having made that determination with a broad sweep. *Stewart* also confirms that a title insurer will not always be found to be in the best position to prevent the loss caused by misconduct in connection with a real estate closing.■



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