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Why You Should Advise a Buyer to Purchase Owner's Title Insurance

from the desk of David M. Touchstone

First: a disclaimer. I sell title insurance. I make money from selling title insurance. But I truly believe in title insurance, because it really protects consumers.

This article was written with real estate agents in mind. But it also applies to loan originators, bankers and builders. In a number of cases decided by Louisiana courts of appeal, the courts have held real estate agents (and their brokers) liable for anything about which the agent undertook *to give advice* which later turned out to be incorrect. That's why you better think twice when your client asks you about title insurance.

How many times have you been at the closing table and your client (buyer) looked to you for advice as to whether he should elect to purchase owner's title insurance?

Agents respond to this question in a number of different ways. We submit that there is only one right answer: "Yes." Here's several good reasons why:

First, it's cheap. In most sales the lender requires a lender's title policy. By purchasing owner's coverage at the same time, the buyer can "piggy back" on the premium. In other words, in those instances, he can buy the owner's policy for about one-third of the normal premium. When compared with the risk of title failure, the owner's premium is very small indeed. And even

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if your buyer succeeded in court in protecting his right of ownership, what about the costs of defending that right in court? Costs of that nature could prove to be financially devastating to your client. Title insurance pays for legal representation.

Second, why take the risk? Suppose you counsel the buyer not to purchase the owner's policy. If it turns out that there is something wrong with the title, the buyer, holding you responsible, may very well be angry with you. Might not the buyer even claim that you were negligent when you advised him not to protect himself?

The failure of a title may not have been detectable in the title search. Some defects remain hidden despite the most thorough search of public records. Forged deeds, and fraudulent mortgage releases would be an example. Unfortunately forgery is a real

issue. More than once an estranged spouse has had a friend pose as the other spouse in order to fraudulently sell community property. That's why title insurance companies require their agents to obtain legal identification at closing. Deeds executed by a person who is insane or mentally incompetent or under duress would fall into this category as well.

Other defects that would be hidden from the view of a title examiner would include deeds executed by an unauthorized party. A deed signed by a person on behalf of a corporation unauthorized by the corporation, a deed signed by a person on behalf of a partnership unauthorized under the partnership agreement, a deed from a trustee unauthorized under the trust agreement, a deed by a minor, a deed executed under a falsified power of attorney, or a deed from a legal nonentity are all potential disasters for a buyer without an owner's policy.

But the greatest dangers to your client comes from title defects which *are* discoverable in a title search. Debts owed by previous owners of the property may have attached to the property in the form of homeowner association liens, paving liens, property standards liens, state tax liens, IRS liens, personal money judgments, unpaid mortgages, etc. Any person holding such a secured debt has a probable right of seizing your client's property and putting it on the public auction block. Other persons such as co-owners or tax sale purchasers may have rights in the property which should have been discovered, but weren't.

Well, you may be thinking, as to these matters which *were* discoverable from the public records, my client can just go back against the title agent who did the closing. But what if the agent is dead? Or out of business? Or bankrupt? What if the title agent takes the position that he did not guarantee the title, only facilitated the preparation of the closing documents? What if too much time has transpired to hold the title agent legally responsible? What if the title agent is an empty corporate shell with no assets and no malpractice insurance?

In 1997, the Louisiana legislature passed the Title Insurance Act. One feature of this act states that in purchase transactions, the buyer must be offered the opportunity to purchase an owner's title policy if a lender's title policy is being written on behalf of the lender. While no cases have arisen on this point yet, it is very likely a title agent who missed a title defect in the courthouse search could use this provision to escape liability for a negligence claim. What if the agent says, "Well, Mr. Buyer, you had the chance to protect yourself and you were too cheap to pay for it and specifically *rejected* this protection. I did not undertake to guarantee you." The Courts might just buy this argument.

In addition to the risks posed to buyers by non-discoverable and discoverable title defects, is the grave danger posed by labor and material liens. Why am I setting this out in a different category? Because these present a huge risk to the buyer and can occur *AFTER* the closing. Under the Louisiana Private Works Act, persons who supplied labor or materials to build or repair structures have (in some cases) up to seventy days after *substantial completion* of the structure to file a lien. Scenario: Builder completes house and ten days later sells the house. For the next sixty days, the buyer is exposed to the possibility that the builder did not pay, say

$50,000.00, to his suppliers. Who pays? Well, if the buyer can't catch up with the builder, the buyer pays.

The last category, I shudder to discuss. What about fraud by title insurance agents? In California, a few years back, a title agent was caught for stealing money out of his escrow account that should have been used to pay off sellers' mortgages. How did he keep up this racket long enough to steal millions? He had the sellers' mortgage servicing switched to himself, and he kept making the payments on the sellers' mortgages. In Louisiana, we had the Charter Title debacle. A few years back, Charter Title was one of the biggest title agents in New Orleans. Charter Title had so much money going through its escrow account that the principals (who went to prison) were able to skim millions off the "float." All they had to do was to delay mortgage payoffs long enough. With lots of places to gamble and the inevitable slowing of the bull market, we will certainly see one of our "toadstool" title agencies implicated in fraud. When this happens, a *seller's* mortgage company will come for your buyer's house. If your buyer has an owner's policy, the title insurance company will pay off the seller's old mortgage. If your buyer doesn't have owner's coverage, who will he sue? The title agent who's on his way to prison or you who pointed him to Toadstool Title and then compounded your error by telling him, "Oh, you don't need that" when he asked you about owner's title insurance?

If you are not now advising your buyer clients to purchase owner's title insurance, you should rethink this position.