Closing Do's and Don'ts

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Closing Do's and Don'ts[1]

The real estate closer or escrow officer (referred to in these materials as an "escrow officer") should understand what he or she has a legal obligation to do and not do. Those legal duties are not mere common sense, and there is often more than one right choice. However, in most situations, good procedures will allow the escrow officer to treat everyone fairly and avoid a dispute. These materials review what the courts have said and translate those rulings into practice pointers. This is not an escrow procedure manual, and the comments made here do not embody the procedures of any title insurer or agency.

1) Basic Principles of Escrow

a) Types of Escrows

California and other western states have a "pure" escrow system. The buyer, seller and lender give escrow instructions to the escrowee. They then deposit money and documents. Escrow breaks when all deposits are made. The escrowee then delivers the money and documents according to the instructions. The escrow function is separate from the insurance of title. Until recently, most escrows in California were handled by independent escrow companies, not title underwriters or agents.

The table closing which is common in the rest of the country is also an escrow. Buyer and seller deposit money and documents with the escrow officer at the table. Instructions are normally spoken, not written. Most lenders give written escrow instructions. The lender tells the escrow officer that he or she may deliver the loan funds when certain conditions have been met.

There are also numerous types of escrows for purposes other than the closing of a sale or loan. The most common such escrows are construction disbursing or control, punchlist and completion escrows on new construction, earnest money, environmental cleanup disbursement, and post-closing holdback escrows. A company acting as qualified Escrowee in a tax-deferred (Section 1031) exchange is an escrowee with particular duties and relationships tailored to the tax code.

The same principles apply to all of the above types of escrows.

b) The Escrowee's Role

How does the law define the role of an escrow officer? There are several common misconceptions. Some would say that an escrow officer works for the escrow principal who is a

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repeat customer, but not the other party to the escrow. In some states, a common belief is that the escrow officer's only job is to put the closing figures and documents together for the real estate broker. In fact, an escrow officer has a duty to all parties to the escrow (typically buyer, seller and lender), and normally has no duty to others involved in the transaction such as the real estate broker.

The escrow officer is both the limited agent of the people who deliver deposits into escrow (the "principals"), and also must be neutral. The first idea is limited agency, which has been described this way:

> [T]he escrow holder is generally considered the agent of both parties to the escrow, and he owes an obligation to each party measured by an application of the ordinary principles of agency. Such agency has been held to be for the limited purpose of the escrow, and to continue until the escrow is closed.[2]

California refers to the escrowee as "the limited agent and fiduciary of all parties to an escrow."[3] This agency "is limited because the escrow agent only represents his principals insofar as he carries out the escrow instructions."[4] Other states also consider the escrowee to be a limited agent of the parties to the escrow.[5]

The second idea is that the escrow officer must be a "neutral stakeholder" in the transaction.[6]

> The escrow relationship is a stakeholder relationship that carries special duties. ...An escrow agent acts as a neutral third party.[7]

Thus, an escrow officer cannot take sides between buyer and seller, but must treat all of the people who make deposits fairly and equally.

How can the escrow officer both be neutral and the agent of the parties who make deposits? The key is that the escrowee is the parties' agent only to carry out the limited

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[2] 30A C.J.S. Escrows § 10 (footnotes omitted).

[3] *Hannon v. Western Title Ins. Co.*, 260 Cal. Rptr. 21, 23 (App. 1989); *Kirby v. Palos Verdes Escrow Co.*, 183 Cal.App.3d 57, 64-65, 227 Cal.Rptr. 785 (1986); *Spaziani v. Millar*, 215 Cal.App.2d 667, 30 Cal.Rptr. 658.

[4] *Hannon v. Western Title Ins. Co.*, 260 Cal.Rptr. 21, 23 (App. 1989).

[5] *Gurley v. Bank of Huntsville*, 349 So.2d 43 (Ala. 1977); *Shaheen v. American Title Ins. Co.*, 120 Ariz. 505, 508, 586 P.2d 1317, 1320 (Ct.App. 1978); *Fretz v. First American Title Ins. Co.*, 161 Ariz. 174, 777 P. 2d 672 (App. 1989).

[6] *Citizens National Bank of Roswell v. Davisson*, 229 U.S. 213, 223 (1913); *Bell v. Safeco Title Ins. Co.*, 830 S.W.2d 157 (Tex.App. 1992); *Wilson v. Carver Fed. Savings & Loan Ass'n*, 774 S.W.2d 106 (Tex.App.--Beaumont 1989).

[7] *Bell v. Safeco Title Ins. Co.*, 830 S.W.2d 157 (Tex.App. 1992). Note, however, that Texas also considers the escrowee a fiduciary (see below).

instructions given by them, such as to record a document or disburse money to the named person.[8]

Some states impose a high duty on escrowees to handle deposits carefully. They say that an escrowee is a fiduciary.[9] A fiduciary is a person in a position of "great confidence or trust" in handling other people's property. Florida says an escrowee is a fiduciary when the buyer and seller do not have lawyers.[10] Similarly, Ohio considers escrowed funds to be held in "a trust-like arrangement."[11]

Thus, an escrow officer's duty is to each person who delivers money or documents to the escrow officer. The escrow officer becomes the limited agent of each such person, and must treat all of the people fairly, not taking sides on an issue. The escrow officer must handle documents and money carefully.

States differ as to whether or not an escrow officer can owe a duty of care to a person who gets paid from the escrow, but is not a principal. Some states say that an escrowee cannot be sued by a payee.[12] Other states, notably Missouri, hold that at least certain payees are third party beneficiaries of the escrow.[13] A legal encyclopedia takes the second view:

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8 In *Blackburn v. McCoy*, 1 Cal.App.2d 648, 37 P.2d 153, 155, the court explained:

"There seems to be a divergence of opinion in the books as to whether the status of an escrow holder is that of an agent or trustee for the parties to the escrow. Conceding that the escrow instructions created an agency in the defendant Title Guarantee and Trust Company for the several parties to the escrow, as contended for by appellant Blackburn, it could not be a general agency for each one of the parties because their interests were conflicting. The status could only properly be classified as an agency on the theory that there was a limited agency as to each party to the escrow, whereby the duties and obligations owing by the escrow holder to each would not conflict with the duties it owed to the other. The usual purpose that prompts the creation of an escrow is the desire of persons dealing at arm's length with each other to have their conflicting interests handled by one person in such a manner as to adequately protect the rights of each of the parties to the transaction. The fundamental principles underlying the obligations of a general agency would not, and could not, tolerate the operation of an escrow, such as we have here, as a general agency. If the several escrow instructions create in the escrow holder an agency, it must be one limiting the obligations of the escrow holder to each party to the escrow in accordance with the instructions given by such party. This in practice has been and is the underlying principle that has made possible the development of the escrow method of handling transactions which has become such an important factor in conveyancing and other business activities. Upon this theory, it has been given almost universal judicial sanction in this and other jurisdictions."

9 *Boatright v. Texas American Title Co.*, 790 S.W.2d 722 (Tx. 1990); *Bell v. Safeco Title Ins. Co.*, 830 S.W.2d 157 (Tex.App. 1992); *Tucson Title Ins. v. D'Ascoli*, 94 Ariz. 230, 234, 383 P. 2d 119, 121 (1963); *Francis v. Eisenmayer*, 171 Cal.App.2d 221, 225-227, 340 P.2d 54; *Karras v. Title Ins. & Guarantee Co.*, 118 Cal.App.2d 659, 258 P.2d 866 (1953); *Chicago Title & Trust Co. v. Cleary*, 319 Ill.App. 83, 48 N.E.2d 576 (1943); *National Bank of Washington v. Equity Investors*, 81 Wash.2d 886, 506 P.2d 20 (1973).

10 *Gerson v. Broward County Title Co.*, 116 So.2d 455, 457 (Fla. 1959).

11 "The depositary under an escrow agreement is an agent of both parties, as well as a paid trustee with respect to the purchase money funds placed in his hands." *Pippin v. Kern-Ward Bldg. Co.*, 8 Ohio App. 3d 196, 198 (1982) [quoted with approval in *Shafron Enterprises Defined Benefit Pension Plan v. Midland Title Security Inc.*, 602 N.E.2d 253 (Ohio App. 1992)].

12 *Dorsett Bros. v. Safeco Title Ins. Co.*, 880 S.W.2d 417 (Tex.App.--Houston [14th Dist.] 1993) (subcontractor not a third party beneficiary of escrow just because a check deposited with escrowee had subcontractor's name in remarks line); *Goldberg v. R.J. Longo Construction Co.*, 54 F.3d 243 (5th Cir. 1995) (Texas law); *Bescor, Inc. v. Chicago Title & Trust*

Generally, an escrow agent is not liable to a third-party beneficiary for breach of its fiduciary duty. However, an escrow agent may be liable to a non-party for negligent performance of contractual obligations where the non-party's reliance upon proper performance is known and anticipated.[14]

c) Escrow Instructions

The escrowee's duty is to follow the escrow instructions. In California, instructions must be in writing.[15] Some states allow a person to add instructions orally, when there are written instructions.[16]

When two or more parties give instructions, they must be consistent or there is no escrow.[17] If instructions are unclear or inconsistent, the escrow officer should get them clarified before proceeding.

All parties must sign or agree to changes in the escrow instructions.[18] Instructions from more than one person cannot be changed unless all sign the changes.[19] However, if one person

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Co., 113 Ill.App.3d 65, 68 Ill.Dec. 812, 446 N.E.2d 1209 (App.Ct. 5 Dist. 1983) (subcontractor not third party beneficiary of escrow); *Arizona Title Ins. & Trust Co. v. O'Malley Lumber Co.*, 14 Ariz.App. 486, 484 P.2d 639 (1971) (no duty to subcontractor except to make accurate statements about escrow).

[13] *O'Neil Lumber Co. v. Allied Builders Corp.*, 663 S.W. 2d 326 (Mo.App. 1983) (general contractor is third party beneficiary of construction loan escrow); *H.B.I. Corp. v. Jiminez and Ticor Title Ins. Co.*, 803 S.W.2d 100 (Mo. 1990) (same); *F.D.I.C. v. Calhoun*, 34 F.3d 1291 (5th Cir. 1994) (FDIC as successor to failed lender not precluded from recovery on claimed reliance on escrowee's acts in fostering bank fraud).

[14] 30A C.J.S. Escrows § 10.

[15] The escrowee was negligent in performing the escrow with no instructions from one party, and when the signing person modified the instructions without telling the others. *Flyer's Body Shop Profit Sharing Plan v. Ticor Title Ins. Co.*, 185 Cal.App.3d 1149, 230 Cal.Rptr. 276 (1986).

[16] As noted in *Claussen v. First American Title Guaranty Co.*, 186 Cal.App.3d 429, 435,436, 230 Cal.Rptr. 749 (1986), "escrow instructions may be oral, even when some are in writing (citations) and some escrow instructions may be implicit in the express instructions given.' (Gordon v. D & G Escrow Corp. (1975) 48 Cal.App.3d 616, 621-623 [122 Cal.Rptr. 150]--escrow instructions implicitly required proceeds of sale to be paid to both sellers.)." Also see *Kirk Corp. v. First American Title Co.*, 270 Cal. Rptr. 24 (App. 1990).

[17] *Cloud v. Winn*, 303 P.2d 305 (Okla.).

[18] *Jones v. Title Guar. & Trust Co.*, 178 Cal. 375, 173 P. 586 (1918); 28 Am.Jur.2d Escrows § 5.

[19] *Katleman v. U.S. Communities*, 197 Neb. 443, 249 N.W.2d 898 (1977); *Scholz Homes, Inc. v. Wallace*, 590 F.2d 860 (10th Cir. 1979); Burke, *Law of Title Insurance*, § 18.2, p.18:5. In *Osborn v. Grego*, 596 P.2d 1233 (Kan. 1979), for example, a completion or "punchlist" escrow on new construction was amended by phone by the builder, without like approval by the homeowner, which was not a binding amendment. However, the homeowner's later acts ratified the amendment. See page 420 regarding ratification. *Ogdahl v. Title Ins. & Trust Co.*, 72 Cal.App.3d 41, 140 Cal. Rptr. 148 (1977); *Scholz Homes, Inc. v. Wallace*, 590 F.2d 860 (10th Cir. 1979); *Dickens v. First American Title Ins. Co. of Arizona*, 784 P.2d 717 (Ariz.App. 1989); Burke, *Law of Title Insurance*, § 18.2, p.18:5.

knows that the other person changed the instructions and does not object to the change, the change is approved (ratified).[20]

An escrow officer is supposed to use common sense when escrow instructions do not spell out every detail of how an instruction is to be accomplished.[21] If the escrow officer gets a document for recording without written instructions, he or she should use good judgment as to when the document should be recorded. One court found that the terms of the instrument itself gave the implied instructions about recording it.[22]

A frequent source of heartburn for escrow officers is the person who tries to stop the escrowee from doing what the instructions say. When the instructions are clear, the escrowee must obey them even if one of the people objects. For example, when the instructions told the escrowee to draw on a letter of credit deposited as earnest money if the buyer defaulted, the escrowee was obliged to draw on the letter even though the buyer forbade it.[23] An escrowee is not liable if it performs according to instructions.[24]

d) "Insured" Closings and Closing Protection Letters

Some would say that the title company "insures" the closing. This idea is dangerously wrong. There is no such thing as an "insured" closing. Many escrow officers work for title underwriters or agencies, but the insurance and closing functions are separate. To avoid confusion, an escrow officer should never say that the closing is "insured."

One source of this confusion may be the closing protection letter, often improperly called an "insured closing letter." In a closing protection letter, a title underwriter protects the person who gets the letter from harm caused by its appointed title agency if the agency loses or steals the money or documents. Most letters are issued to lenders. Some versions of the letter also protect against the agency's violation of the letter-holder's escrow instructions.

A closing protection letter is not insurance. Also, only the person who receives the closing protection letter has a right to collect under the letter.

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[20] *Osborn v. Grego*, 596 P.2d 1233, 1237 (Kan. 1979); *Common Wealth Ins. Systems, Inc. v. Kersten*, 40 Cal.App.3d 1014, 115 Cal.Rptr. 653 (1974).

[21] *Kirk Corp. v. First American Title Ins. Co.*, 270 Cal. Rptr. 24 (App. 1990); *Claussen v. First American Title Guaranty Co.*, 186 Cal.App.3d 429, 435,436, 230 Cal.Rptr. 749 (1986); *Gordon v. D & G Escrow Corp.*, 48 Cal.App.3d 616, 621-623, 122 Cal.Rptr. 150 (1975).

[22] The court placed all of the onus on the escrowee for obtaining written instructions, saying that it "failed to execute such an agreement with the parties." *Lacy v. Ticor Title Ins. Co.*, 794 S.W.2d 781, 786 (Tex.App. 1990).

[23] *Lacy v. Ticor Title Ins. Co.*, 794 S.W.2d 781 (Ct.App. 1990).

[24] In *Colonial Savings & Loan Ass'n v. Redwood Empire Title Co.*, 236 Cal.App.2d 186, 46 Cal.Rptr. 16 (1965), the instructions required that the insurer-escrowee issue policies insuring the deeds of trust as first liens, but "subject to exceptions No. 2, 3 and 4" of the title commitments. One of those exceptions was for assessments of a special assessment district. Therefore, it was not a breach of instructions to break escrow and issue policies subject to such assessments.

e) Standard of Care for Escrow Officers

The escrow officer is to faithfully follow the instructions. The escrow officer must exercise ordinary skill and diligence.[25] If it acts negligently, it is liable for any loss directly caused by that negligence.[26] An escrowee is not liable if it performs according to the instructions.[27]

An escrowee has an implied obligation to do all of the things normally done by an escrowee which were not expressly excluded by the escrow instructions.[28] If the escrow officer violates an instruction or an implied promise, the injured person may sue for breach.[29]

An escrow officer's mistake may be considered either a breach of contract or negligence.[30] If the escrowee concedes that the instructions are a contract, they are treated as such.[31]

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[25] *Biadi v. Lawyers Title Ins. Corp.*, 374 So.2d 30 (Fla.App. 1979); *Kirk Corp. v. First American Title Co.*, 270 Cal.Rptr. 24 (App. 1990), citing *Common Wealth Ins. Systems, Inc. v. Kersten*, 40 Cal.App.3d 1014, 1030-1031, 115 Cal.Rptr. 653 (1974), in turn citing *Amen v. Merced County Title Co.*, 58 Cal.2d 528, 532, 25 Cal.Rptr. 65, 375 P.2d 33; *Rianda v. San Benito Title Guar. Co.*, 35 Cal.2d 173, 217 P.2d 25.

[26] *Kirk Corp. v. First American Title Co.*, 270 Cal.Rptr. 24 (App. 1990), citing *Common Wealth Ins. Systems, Inc. v. Kersten*, 40 Cal.App.3d 1014, 1030-1031, 115 Cal.Rptr. 653 (1974), in turn citing *Amen v. Merced County Title Co.*, 58 Cal.2d 528, 532, 25 Cal.Rptr. 65, 375 P.2d 33; *Rianda v. San Benito Title Guar. Co.*, 35 Cal.2d 173, 217 P.2d 25; *Banville v. Schmidt*, 37 Cal.App.3d 92, 106, 112 Cal.Rptr. 126; and *Spaziani v. Millar*, 215 Cal.App.2d 667, 682-683, 30 Cal.Rptr. 658.

[27] In *Colonial Savings & Loan Ass'n v. Redwood Empire Title Co.*, 236 Cal.App.2d 186, 46 Cal.Rptr. 16 (1965), the instructions required that the insurer-escrowee issue policies insuring the deeds of trust as first liens, but "subject to exceptions No. 2, 3 and 4" of the title commitments. One of those exceptions was for assessments of a special assessment district. Therefore, it was not a breach of instructions to break escrow and issue policies subject to such assessments.

[28] *Kirk Corp. v. First American Title Co.*, 270 Cal.Rptr. 24 (App. 1990); *Bruckman v. Parliament Escrow Corp.*, 190 Cal.App.3d 1051, 1056, 235 Cal.Rptr. 813 (1987).

[29] *Kirk Corp. v. First American Title Co.*, 270 Cal.Rptr. 24 (App. 1990); *Rianda v. San Benito Title Guar. Co.*, 35 Cal.2d 170, 173, 217 P.2d 25 (1950); *Claussen v. First American Title Guaranty Co.*, 186 Cal.App.3d 429, 435, 230 Cal.Rptr. 749 (1986).

[30] *Tucson Title Ins. v. D'Ascoli*, 94 Ariz. 230, 234, 383 P. 2d 119, 121 (1963); *Francis v. Eisenmayer*, 171 Cal.App.2d 221, 225-227, 340 P.2d 54; *Karras v. Title Ins. & Guarantee Co.*, 118 Cal.App.2d 659, 258 P.2d 866 (1953); *Chicago Title & Trust Co. v. Cleary*, 319 Ill.App. 83, 48 N.E.2d 576 (1943); *Banville v. Schmidt*, 37 Cal.App.3d 92, 112 Cal. Rptr. 126 (1974); *Amen v. Merced County Title Co.*, 58 Cal.2d 528, 25 Cal.Rptr. 65, 375 P.2d 33 (1962); *Common Wealth Ins. Systems, Inc. v. Kersten*, 40 Cal.App.3d 1014, 115 Cal.Rptr. 653 (1974); *Hannon v. Western Title Ins. Co.*, 260 Cal. Rptr. 21 (App. 1989).

[31] In *Bear Creek Planning Comm. v. Title Ins. & Trust Co.*, 164 Cal.App.3d 1227, 211 Cal.Rptr. 172 (1985), the escrowee conceded that "it was **contractually** bound to record" by virtue of an escrow, causing the court to construe the escrowee's duties as contractual rather than in tort.

f) Checklist for Drafting or Reviewing Escrow Instructions

Many escrow disputes come about because the instructions were not clear, and people disagree when it is time to act on them. There are certain key ingredients in every set of escrow instructions that reduce the likelihood of an impasse. Sample standard clauses for escrow instructions are found in the appendix.

Get written instructions before accepting any deposits. If a deposit is accepted without instructions, such as earnest money delivered with instructions to follow, the escrow officer has no way to know what is to be done if there is a dispute over the money. Sometimes, the threat to return a deposit immediately causes the parties to deliver instructions quickly. If instructions do not arrive immediately, the escrow officer avoids difficulty by returning the deposit to the person who sent it.

Get consistent instructions from all parties. All escrows involve more than one person. All of the principals must give written instructions, and they must be identical (joint) or consistent. Avoid separate instructions from different principals when possible, because there is a greater chance that they will be inconsistent.

Make sure that all possible outcomes are addressed. A common source of disputes is the "optimistic" instruction that only covers what the escrowee is to do if the transaction proceeds as planned. Most disputes arise when things do not go as expected. Make sure the instructions explain what the escrow officer is to do with deposits if the deal does not close, or all deposits are not received. For every triggering event, the instructions must describe what happens if the event occurs or does not occur.

Include a drop dead date. Instructions should always say what the escrow officer is to do if all of the deposits are not received by a specified date. This date should be put on the escrow calendar. Often, the last instruction is to simply return all deposits to the depositors. If the escrow instructions have a triggering event, such as the delivery of a key document, the instructions should state what is to be done if the event does not occur.

Include the right to give money to a court. Delivery of money to a court is called interpleader. When the principals fight over the right to the money, particularly via a lawsuit, the escrow officer should have the right to deliver the money to the court. Interpleader should release the escrowee of any further obligations about the money, since the issue (and the money) are now in the court's hands.

Include an escrow fee, and additional fees if additional work. In some locations, escrow officers gets roped into convenience escrows done at no charge. This is often done on the guess that there will not be significant labor or risk in the escrow. If this assumption is wrong, the escrow officer can spend considerable time and money on a free escrow. Instructions should always incorporate an escrow fee, and the escrowee should be entitled to charge additional fees if there is additional or extended work.

Preserve the right to resign. The escrowee should always have the right to resign from an escrow that becomes unworkable or too burdensome. This right should exist whether or not the instructions include it. However, it is good practice to include a statement about resignation, and the type of notice to be given.

Make sure the principals include their addresses. If the escrow officer has to return deposits or make a demand on a principal later, it is impossible to do so if the principals cannot be found. Make them put their addresses and telephone numbers in the instructions, along with a promise to give the escrow officer any change of address.

2) Duties of Escrow Officers in Recording Documents

The recent case of *Meerhoff v. Huntington Mortgage Co.* is the latest in a series of decisions about the escrowee's duties when it is asked to record instruments. In *Meerhoff*,[32] an escrowee recorded a deed and mortgage six days after closing. A lien was recorded against the seller during the gap. The lender-escrowee was found liable to the buyer for the cost of settling with the lienholder.

Meerhoff is in line with earlier cases holding an escrowee responsible if it takes an unreasonably long time to record. *In Lawyers Title Co. of Houston v. Authur*,[33] the failure to record a release of a mortgage for about a year was found a breach of duty, especially given the fact that the escrowee's senior officer assured the party that "everything necessary to the closing had been accomplished." The delay cost the party a premium for a bond which had to remain in place until the lien was removed. Similarly, in *Lawyers Title Ins. Corp. v. Pokraka*,[34] the insurer-escrowee breached its duties by covenanting with the buyer not to record the seller's purchase-money mortgage for 90 days after closing. In the meantime, the purchaser obtained additional financing which primed the seller's mortgage. Finally, in *Bear Creek Planning Comm. v. Title Ins. & Trust Co.*,[35] the escrowee was responsible for failing to promptly record covenants, conditions and restrictions, which were unenforceable because the property was deeded before the CC & Rs were recorded.

The escrowee also may be liable for any damage proximately caused by violation of other duties regarding the recording of instruments. Escrowees have been found responsible for:

1. failing to record altogether.[36]

2. recording an instrument before receiving authority to do so.[37]

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[32] 103 Ohio App.3d 164, 658 N.E.2d 1109 (3rd Dist. 1995).

[33] 569 S.W.2d 578 (Tex. 1978).

[34] 595 N.E.2d 244 (Ind. 1992).

[35] 164 Cal.App.3d 1227, 211 Cal.Rptr. 172 (1985).

[36] *Robinson v. Carney*, 632 A.2d 106 (D.C.App. 1993); *Boatright v. Texas American Title Ins. Co*., 790 S.W.2d 722 (Tex. 1990).

3. recording documents out of the order given by written instruction.[38]

4. recording a defective instrument.[39]

5. Accepting a deposited instrument which was similar to but not the same as the instrument called for in the instructions.[40]

3) Duties of Escrow Officers in the Handling of Funds

a) Deposit of Funds

An escrowee must exercise reasonable care in handling money deposited into escrow. The escrowee should be sure that funds are received from the correct party.[41] It must deposit checks within a reasonable time after receiving them, or it may be liable if the checks are not good when finally deposited.[42] If funds are not deposited as called for in the escrow, or the deposited check is no good, the escrowee should notify the other party.[43]

Unless there is a state law to the contrary, an escrowee does not have a duty to deposit funds in an interest-bearing account.[44] An escrow agreement may allow the escrowee to earn interest on funds held.[45]

b) Disbursements

The escrowee also has a duty to disburse funds according to instruction. It "must strictly comply with the terms of the escrow agreement and may not use the proceeds in any manner that

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[37] *Zang v. Northwestern Title Co.*, 185 Cal.Rptr. 176 (App. 1982); *Alamo Lumber Co. v. Lawyers Title Ins. Corp.*, 439 S.W.2d 423 (Tex.App.Civ. 1969).

[38] *Sanders v. Park Towne, Ltd*., 2 Kan. 212, 596 P.2d 1233 (1979).

[39] *Stewart Title Ins. Co. v. Equitable Land Service, Inc*., 616 N.Y.S.2d 650 (A.D. 2 Dept. 1994).

[40] *Common Wealth Ins. Systems, Inc. v. Kersten*, 40 Cal.App.3d 1014, 115 Cal.Rptr. 653 (1974).

[41] See *Commercial Escrow Co. v. Rockport Rebel, Inc*., 778 S.W.2d 532 (Tex.App. 1989).

[42] See *Wade v. Lake County Title Co*., 6 Cal.App.3d 824, 86 Cal.Rptr. 182 (1970); *Chilton v. Pioneer National Title Ins. Co.*, 554 S.W.2d 246 (Tex.App. 1977); *Katleman v. U.S. Communities, Inc*., 197 Neb. 443, 249 N.W.2d 898 (1977); *Countrywide Realty Corp. v. Alboni*, 420 A.2d 1181 (Del.Super.Ct. 1980).

[43] *Chilton v. Pioneer National Title Insurance Co*., 554 S.W.2d 246 (Tex.App. 1977); *Burman v. Richmond Homes Ltd*., 821 P.2d 913 (Colo.App.1991).

[44] *Hannon v. Western Title Ins. Co*., 260 Cal. Rptr. 21, 25 (App. 1989).

[45] *Marshall v. New York City Health and Hospitals Corp*., 588 N.Y.S.2d 364 (1992).

is not authorized by contract or deposit."[46] The escrowee should not disburse funds without the parties' approval.[47] No deposits may be released until escrow closes, unless instructions specifically so provide.[48] When a check was deposited containing an endorsement stating that the money was for purchase of land, the endorsement created an implied instruction not to disburse funds until land was conveyed.[49] Instructions to use the funds "to clear title" before disbursing the balance to the seller were found to require clearing of even those liens which might be junior to the title conveyed.[50] An escrowee may be required to reimburse a party for earnest money improperly disbursed.[51] If the principal to the escrow modifies its instructions regarding payment of its own funds, either before or after the break of escrow, the escrowee is obligated to follow those instructions.[52]

When two people sign instructions as sellers, the proceeds check should be cut to both of them, unless otherwise directed.[53] However, the escrowee is not responsible for loss caused by one seller's forgery of the other's signature on a check properly payable to both of them but delivered just to one.[54]

c) Other Duties

An escrowee has few, if any, implied duties regarding the handling of money. In an escrow for collection of land contract payments, the escrowee did not violate a duty by accepting a late payment, or one lesser in amount than was due and payable.[55] Also, when an escrowee was instructed merely to send funds to pay off a mortgage, it had no duty to verify its later discharge.[56] A recent New York case, however, raised the suggestion that an escrowee could owe a fiduciary

[46] *Colonial Savings and Loan Ass'n v. Redwood Empire Title Co*., 46 Cal.Rptr. 16 (Ct.App. 1965).

[47] *Commercial Escrow Co. v. Rockport Rebel, Inc.*, 778 S.W.2d 532 (Tex.App. 1989).

[48] *Karras v. Title Ins. & Guarantee Co*., 118 Cal.App.2d 659, 258 P.2d 866 (1953); *Broussard v. Hill*, 100 Nev. 325, 682 P.2d 1376 (1984).

[49] *Wieland v. Ticor Title Ins. Co*., 755 S.W. 2d 659 (Mo. App. 1988).

[50] *First Montana Title Co. of Billings v. North Point Square Assoc*., 240 Mont. 33, 782 P.2d 376 (Mont. 1989).

[51] *Durish v. Panan International N.V*., 808 S.W.2d 175 (Tex.Ct.App. 1991).

[52] *Contemporary Investments, Inc. v. Safeco Title Ins. Co*., 145 Cal.App.3d 999, 193 Cal.Rptr. 822 (Cal.App. 4 Dist. 1983).

[53] *Gordon v. D & G Escrow Corp.*, 48 Cal.App.3d 616, 621-623, 122 Cal.Rptr. 150 (1975).

[54] *Gerson v. Broward County Title Co.*, 116 So.2d 455 (Fla. 1959).

[55] *Malta v. Phoenix Title & Trust Co*., 76 Ariz. 116, 259 P.2d 554 (1953).

[56] *Hooper v. Commonwealth Land Title Ins. Co*., 285 Pa.Super. 265, 427 A.2d 215 (1981).

duty to a mortgagee which delivered its satisfaction to the escrowee on the representation that it would be paid when escrow broke.[57]

d) Disputes and Mistakes

In certain situations, the escrowee desires or is required to deliver the funds to a court of competent jurisdiction as full satisfaction of its obligations. This may be done by interpleader. If no lawsuit has been brought, the escrowee will ordinarily have to bring at least a motion for interpleader, and perhaps a civil suit plus the motion. The order should accept delivery of the funds and release the escrowee from any further liability. When the agreement so provides, the escrowee is entitled to be reimbursed for its expenses.[58] If the escrowee has received inconsistent instructions, or there is a dispute between the parties as to what the escrowee should do, the escrowee should act immediately to obtain such an order. However, payment to the party named in a court order instructing the escrowee was still error, when the escrowee had prior notice that the named party had assigned his interest in the money to another.[59]

When the escrowee makes a mistake in the handling of funds, it most often has a right to recover from the party in whose favor the mistake was made. The escrowee may sue people who were paid incorrectly out of escrow.[60] A seller that signed an agreement "to fully cooperate and adjust for clerical errors on any or all documents deemed necessary in the reasonable discretion of" the settlement agent obligated it to reimburse the closer for taxes.[61] When the escrowee prepared the closing statement and listed the sale price as $2,000 too little, the buyer was obligated to pay the escrowee back after it made up the difference to the seller. The payment to the seller was not a "voluntary payment," as the buyers argued.[62] Title insurers who made mortgage payoffs to a mortgage broker which had arranged the loans and which had accepted the monthly payments from the borrowers were entitled to an injunction against the foreclosure of the mortgages. The court found that the mortgage broker had been the dual agent of borrowers and mortgagees.[63]

However, there are some cases in which the escrowee cannot recover money paid out improperly. In one case an insurer made an error on the seller's mortgage payoff amount, and sought the difference from the seller after making the full payoff. Because the insurer had issued a policy to the seller for a purchase-money mortgage, the court denied recovery on the insurer's

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[57] *T.T.S.G., Inc. v. Kubic*, 639 N.Y.S.2d 825 (A.D. 1 Dept. 1996).

[58] *Schuhman v. Green River Motel*, 835 P.2d 992 (Utah App. 1992).

[59] *Wood v. Chicago Title Agency of Las Vegas, Inc*., 847 P.2d 738 (1993).

[60] *Julian W. Curtis Co. v. District-Realty Title Ins. Corp.*, 267 A.2d 830 (D.C. 1970).

[61] *Charter Title Agency, Inc. v. Hosfelt Investment Co.*, 1999 WL 1221527 (Ohio App. 10 Dist.) (unpublished).

[62] *Ticor Title Ins. Co. v. Mundelius*, 887 S.W.2d 728 (Mo.App.S.D. 1994).

[63] *Young v. Nevada Title Co*., 744 P.2d 902, 103 Nev. 436 (1987).

subrogation claim, on the grounds that subrogation may not be sought against an insured.[64] Similarly, an escrowee's claim for recoupment of excess funds paid out was denied as time-barred. The insurer held $9,650.00 in escrow, to be returned on occurrence of an event. When it returned the funds, it issued a check for $96,500.00. The error was not discovered for more than five years. The court held that the escrowee should have known of the error within 60 days of the issuance of the check, since the check would be shown on its next statement.[65]

e) Dealing With Escrow Disputes

The escrowee is entitled to sue for a court ruling telling it what to do if there is a dispute between the principals over the escrow.[66] May also interplead funds to walk away. However, the threat of a lawsuit by one principal is not a good enough reason to permit interpleader, if the instructions clearly say that the other party is entitled to the money.[67] A court order instructing the escrowee to disburse deposited funds in a particular fashion supersedes the escrow instructions.[68] The escrowee may also sue to have the court rescind a deed accidentally released from escrow before it broke.[69]

4) Mortgage Payoff Pitfalls

Mortgage payoff letters create many uncertainties for title company escrow officers. Recent lawsuits from across the country teach these lessons:

Avoid relying on oral payoff figures. In *Jim Carpenter Co. v. Potts*,[70] the lender was not obligated to honor an oral payoff amount. However, the Minnesota Supreme Court has recently said that a lender in that state <u>must</u> honor its oral payoff figure.[71] This case is also very useful when the lender balks at honoring an oral modification to a payoff letter.

Get firm figures for partial releases of blanket subdivision or condominium loans. These loans sometimes have complicated payoff formulae. In the *Jim Carpenter* case, the lender and borrower disagreed about what the payoff amount should be, and the escrow officer was stuck in the middle of the dispute.

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[64] *Castania v. Ticor Title Ins. Co. of California*, 409 S.E.2d 286 (Ga.App. 1991).

[65] *Guaranty Nat'l Title Co., Inc. v. J.E.G. Associates*, 1995 WL 708667 (N.D.Ill.)(unpublished).

[66] *Title Guaranty Escrow Service v. Powley*, 2 Haw.App. 265, 630 P.2d 642 (1981).

[67] *Land Title Co. v. Dubois*, 2000 WL 688253 (Tex.App.-Dallas) (unpublished).

[68] *Kramer v. Chicago Title & Trust Co.*, 69 Ill.App. 3d 1015, 387 N.E.2d 1105 (1979).

[69] *LaSalle National Bank v. Kissane*, 163 Ill.App.3d 534, 516 N.E.2d 790 (1987).

[70] 495 S.E.2d 828 (Va. 1998).

[71] *Smith v. Woodwind Homes, Inc.*, 605 N.W.2d 418 (Minn. 2000).

Pay off the correct loan. When the borrower has more than one loan with the lender, match the loan number for the secured loan to the payoff letter issued by the lender. In a great recent case, the borrower had two loans with the same bank. The escrow officer gave the payoff information for the mortgage loan, but the lender issued the payoff on the personal loan. The court said the lender had a duty to satisfy the mortgage, because people relied on the payoff letter.[72]

Put the property address and loan number on the payoff check or cover letter. In the F.D.I.C. case, the court said an important reason why the lender should honor the incorrect payoff was because the check gave the property address on the reference line. That indicated that the intent was to pay off the mortgage loan, not the unsecured personal loan.

Get proof of authority for loan servicers. Ask a loan servicer <u>before closing</u> for evidence that it can sign a satisfaction. If a loan servicing agent has the power to sign a satisfaction, an escrow officer can rely on that authority until the lender advises the escrow officer that the servicer has been fired.[73]

Close the equity loan account before the payoff is issued. When asking for a payoff letter on a revolving credit equity loans, include a letter signed by the borrower(s) telling the lender to close or freeze the account. Send a second letter signed by the borrower(s) with the payoff check confirming that the account is closed and ordering the lender to satisfy the mortgage. When you ask the borrowers to sign the letters, explain to them that this loan is now closed, that they cannot borrow against it, and the lien of the mortgage does not move with them to their new house. At closing, destroy any credit card or checks related to the account. If you use these letters, the lender should have to satisfy the mortgage even if it mistakenly makes advances under the loan after the loan termination letter is received.[74] When the escrow officer did not send a loan termination letter, the title company had to pay the additional advances in order to get a satisfaction.[75]

Update payoff letters before closing. Call before closing to verify that the payoff figure is still accurate. This also gives the lender a chance to discover any error on the letter. A very good new Virginia case says that the lender has a duty to promptly tell the escrow officer that its payoff letter is wrong.[76] The court noted that the escrow officer called before closing to confirm, but the lender did not correct its error. The case result was based in part on the Virginia law making lenders bound by their loan payoff letters, so the same result cannot be guaranteed in our state.

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[72] *Stewart Title Guar. Co. v. F.D.I.C.*, 936 S.W.2d 266 (Ct.App.Tenn. 1996).

[73] *Banco Santander Puerto Rico v. Select Title Service Inc.*, 692 So.2d 950 (Fla.Ct.App. 1997).

[74] See *First American Title Ins. Co. v. TCF Bank, F.A.*, 676 N.E.2d 1003 (Ill.App. 1997).

[75] *Chemical Bank of N.J. v. Bailey*, 687 A.2d 316 (N.J.Super.A.D. 1997).

[76] *Sovereign Title Co. v. First Union Nat'l Bank*, 4/20/00, 2000 WL 511798 (Va.Cir.Ct.).

Foreclosure payoffs. When the loan is in foreclosure, get the payoff letter from the lender but also get an accurate statement of attorney's fees owed for the foreclosure. The attorney is the person best able to give that accurate amount. However, avoid taking a payoff letter only from the attorney, because he or she may not include late fees, penalties and other charges that the lender believes are owed. The lender may not be bound by a payoff letter issued by the lawyer.[77]

"Hostage" payoff amounts. Colorado has held that a lender cannot condition its satisfaction on the payment of a "penalty" amount on top of the debt. Anticipated attorney fees in foreclosure or other litigation can be used as a penalty. In *Crown Bank v. Crowder Mortgage Corp.*,[78] , the court said that the lender could not condition the satisfaction on payment of attorney fees for a possible future dispute with the borrowers. The court said: "a lender cannot place conditions on its release of a deed of trust [mortgage] other than the satisfaction of the indebtedness secured by that deed of trust. …If a lien holder were permitted further to condition the release of the lien, it could use that ability to coerce settlement of other disputes or accounts a result which the statute clearly intended to prevent." In Colorado, there is a statute regulating payoff letters, but this case may also be useful in other states in dealing with a lender that places undue conditions on satisfaction of the mortgage.

5) Statements and Representations by Escrow Officers

a) Escrowee is Not an Advisor

An escrowee or escrow officer is not an advisor. Rather, most states follow the rule that "[a]n escrow holder, by definition, is a neutral party with no obligation to either party to the transaction except to carry out the terms of the escrow instructions. They owe no duty to advise the parties on their legal rights...[and] [t]hey have no reason to protect the rights of any one party as against another."[79] The escrowee is not an attorney or advisor to the parties to the escrow.[80] The escrowee may wish to remind the buyer and seller that they may obtain counsel.[81]

In the State of Washington, an escrowee is not under any duty to give legal advice or see to it that an escrow party obtains such advice.[82] However, if the escrowee voluntarily performs

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[77] See *Bacich v. Uzzell*, 2000 WL 760440 (Minn.App.) (unpublished).

[78] 2000 WL 674923 (Colo.App.).

[79] *McDonald v. Title Ins. Co. of Oregon*, 49 Or.App. 1055, 621 P.2d 654, 657 (1980).

[80] *State Bar v. Security Escrows. Inc.*, 233 Or. 80, 377 P.2d 334 (1962).

[81] See *Styrk v. Cornerstone Investments, Inc.*, 61 Wash.App. 463, 810 P.2d 1366 (1991) and *Carstensen v. Chrisland Corp.*, 442 S.E.2d 660, 669 (Va. 1994).

[82] *National Bank of Washington v. Equity Investors*, 81 Wash.2d 886, 506 P.2d 20 (1973).

acts which are later found to be the unauthorized practice of law, the escrowee is held to the same standard of care as is an attorney. For example, an escrowee which drew up a promissory note engaged in unauthorized practice of law. Thus, the escrowee became responsible for advising the party that it should not lend without getting a deed of trust as security.[83]

An escrowee does not have a duty to explain the legal effect of a document, even when the escrowee drafted the instrument.[84] The escrowee is not required to explain the effect of amendments to a closing document.[85] Nor does the escrowee have a duty to warn a party that it may be taking an imprudent risk.[86]

b) Escrowee Has Duty to be Truthful and Accurate

However, as in other matters, when the escrowee speaks, it has a duty to speak truthfully. One court said that a buyer could "expect that the title company is providing him or her services" when it performed title and closing services for the buyer's lender. Thus, the title company could be liable for fraudulent misrepresentation to the buyer when its employee examined an incomplete septic system report and announced to the buyer at closing that the system passed a test. [87]

An escrowee may be liable if it volunteers opinions which turn out to be wrong. Such was the case when the escrow officer incorrectly offered that there would be sufficient funds in the escrow to pay all lien claimants.[88] Similarly, an escrowee was liable for volunteering the advice to close on the purchase of a newly-built house although the buyers knew that some workmen had not been paid.[89] Finally, an escrowee was found responsible for harm when the escrow officer represented to various sellers that the purchaser was "an honorable and wealthy man."[90] In the same case, the escrow officer also represented that "earnest money time deposits" were "valid devices in California," and backed by certificates of deposit, the latter statement at least being not true. Based on the pattern of misrepresentation to various sellers, the court upheld a verdict against the insurer based on the Racketeer Influenced and Corrupt Organizations Act (RICO).

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[83] *Bowers v. Transamerica Title Ins. Co*., 100 Wash.2d 581, 675 P.2d 193 (1983). See also *Andersen v. Northwest Bonded Escrows, Inc*., 4 Wash. App. 754, 484 P.2d 488 (1971).

[84] *National Bank of Washington v. Equity Investors*, 81 Wash.2d 886, 506 P.2d 20 (1973), rev'd other grounds 86 Wash.2d 545, 546 P.2d 440 (1976).

[85] *Bell v. Safeco Title Ins. Co*., 830 S.W.2d 157 (Tex.App. 1992).

[86] *Axley v. Transamerica Title Ins. Co.,* 88 Cal.App.3d 1, 151 Cal.Rptr. 570 (1978).

[87] *Bortz v. Noon*, 698 A.2d 1311 (Pa. Super. 1997), reh. den.

[88] *Arizona Title Ins. and Trust Co. v. O'Malley Lumber Co*., 14 Ariz. App. 486, 484 P.2d 639 (1971).

[89] *McDonald v. Title Insurance Co. of Oregon*, 49 Or.App. 1055, 621 P. 2d 654 (1980).

[90] *Bowling v. Founders Title Co*., 773 F.2d 1175 (11th Cir. 1985).

c) Statements about Deposited Funds

An escrowee should not misrepresent the facts about deposited funds. One case found an escrowee liable for intentionally giving the seller the impression that an instrument deposited into escrow is as good as cash. The escrow officer had represented to various sellers that the purchaser was "an honorable and wealthy man," and that "earnest money time deposits" were "valid devices in California," backed by certificates of deposit. At least the last statement was not true. Based on a pattern of misrepresentation to various sellers, the court upheld a verdict against the insurer based on the Racketeer Influenced and Corrupt Organizations Act (RICO).[91] However, as with other matters, the escrowee has no liability, except to the parties to the escrow or third parties with whom it deals directly, for representations it makes regarding funds. Thus, an escrowee was not culpable to a mortgage loan assignee for having "represented" that the loan was funded, when the escrowee was not aware of the assignment and its only "representation" was the HUD-1 certification that funds had been disbursed.[92] The Jefmor court held that the escrowee's "legal duty regarding the truth of the statement that the funds had been disbursed extended no further than to Amerifirst, the party to whom the statement was made."

d) Liability for Bad Advice

Liability for bad advice may be based on Section 552 of the Restatement (Second) of Torts, regarding negligent misrepresentation. An escrowee was liable for negligent misrepresentation in giving bad advice as to the sufficiency of an escrow party's security for a debt.[93] Misrepresentation was also found when an escrowee advised that an indemnity rather than a title insurance policy would be adequate protection against construction liens.[94] Similarly, when the title insurance commitment correctly showed that a building height restriction had been changed by a second restriction, but the escrow officer voluntarily advised the homeowners that a restriction existed and gave them a copy of the earlier version, the escrowee was responsible for the homeowners' reliance on the escrow officer's incorrect information.[95] Likewise, a seller had a valid cause of action for fraud against an escrow officer when the lender failed to fund, but the escrow officer told the seller that the funds would be available the next day.[96]

6) Fraud and the Escrow Officer

a) Escrow Officer Not a Policeman

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[91] *Bowling v. Founders Title Co*., 773 F.2d 1175 (11th Cir. 1985).

[92] *Jefmor, Inc. v. Chicago Title Ins. Co.*, 839 S.W.2d 161 (Tex.App. 1992).

[93] *Mur-Ray Management Corp. v. Founders Title Co.,* 819 P.2d 1003 (1991).

[94] *DeZemplen v. Home Federal Savings & Loan Ass'n*, 221 Cal.App.2d 197, 34 Cal.Rptr. 334 (1963).

[95] *Lindstrand v. Transamerica Title Ins. Co.,* 127 Or.App. 693, 874 P.2d 82 (Or.App. 1994).

[96] *Boenker v. American Title Co.,* 590 S.W.2d 777 (Tex.App. 1979).

The transaction being closed may be a bad bargain for one side, or a get-rich-quick scheme. The escrow officer has no duty to pull one party aside and point out what appears to be a bad bargain or the potential for the investor to lose his or her money. These rules reflect the traditional view that the escrowee is not a policeman, and may not interject its opinion of the economic benefits of the transaction. This view is consonant with the escrowee's position as limited agent of each party.

The California escrowee does not have a duty to report every suspicious fact or sharp practice. One commentator, analyzing the seminal case of *Blackburn v. McCoy*,[97] analyzed the problem thusly:

> The court concluded...that a *general* agency did not exist between the parties and the escrow agent. An escrow agent owes duties to two parties with conflicting interest. The court reasoned that the duty to disclose fraud to one principal conflicts with the duty of loyalty to the other principal.[98]

The "flip" transaction, involving two back-to-back escrows, is a common example of a "sharp" transaction which is not a fraud.[99] In *Lee v. Title Insurance and Trust Co.*,[100] the purchaser agreed to buy at one price, and his seller then obtained the property for less and made the profit on the "flip." The escrowee was alleged to have known about the flip. Lee claimed that the escrowee had a duty to tell him about the double sale to avoid having him pay the higher price.

The *Lee* court found that the escrowee does not have "a fiduciary duty to go beyond the escrow instructions and to notify each party to the escrow of any suspicious fact or circumstance which has come to his attention before or during the life of the escrow which could conceivably affect such party even though the fact or circumstance is not related to his specific escrow instructions."[101] This proposed duty would be too subjective a burden, in light of the escrowee's limited agency. Such a duty would leave the escrowee open to suit from the other party, whose benefit of the transaction would presumably be lost, once exposed:

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[97] *Blackburn v. McCoy*, 1 Cal.App.2d 648, 37 P.2d 153 (1934).

[98] Jacobsen, *California Escrow Agents: A Duty to Disclose Known Fraud?*, 17 Pacific L.J. 309, 315-6 (1985).

[99] The double escrow or "flip" occurs when a party lines up a buyer for property willing to pay more than the amount for which the Escrowee is able to purchase it. The escrows are conducted separately but in rapid succession, with the Escrowee desiring that neither the initial seller nor ultimate buyer know of the other transaction. "As long as the Escrowee buyer-seller is not an agent of one of the parties, and as long as there is no other misrepresentation, the use of the 'double escrow' is a legitimate transaction." Miller & Starr, *Current Law of California Real Estate*, § 12:83 at 395 (1977).

[100] 264 Cal.App.2d 160, 70 Cal.Rptr. 378 (1968).

[101] Id. at 379.

> In fact, under the proposed rule, once an escrow holder received information (from whatever source) he would be forced to decide independently whether to believe the information and disclose it or disbelieve it and conceal his knowledge. If he concealed his knowledge he would risk suit. If he discloses and the information is inaccurate, he may be sued by all parties to the escrow for interfering with their contract. [footnote omitted] For example, in the fourth cause of action of appellants' complaint appellants allege that the other defendants falsely and fraudulently promised appellants that they would obtain tenants and the necessary financing to acquire and remodel the subject real property in order to induce appellants to purchase the property.
>
> Thus, if respondents had informed appellants of these facts, and if it was later discovered that their information was inaccurate, they would have subjected themselves to multiple lawsuits.
>
> Establishing a rule which would create such a dilemma and subject to the escrow holder to a high risk of litigation would damage a valuable business procedure. Manifestly, appellants' contention, if adopted by judicial fiat, would effectively discourage a reasonable and prudent man or company from acting as an escrow holder and would ultimately defeat the very purpose for which escrows originated.[102]

Several other states have adopted the California principle. Alabama followed the *Lee* case in *Gurley v. Bank of Huntsville*.[103] Louisiana recently agreed, in *Resolution Trust Corp. v. American Title Ins. Co*.[104] In that case, a bank made a loan to a partnership in which an officer and director of the bank were partners. The bank also made an unsecured loan to the partnership for its "equity" in the project. The RTC took over the institution, and sued the title insurer on the theory that the insurer's agent (who was also counsel for the bank), who acted as closing attorney for the bank, had a duty to disclose these irregularities to the uninvolved officials of the bank. The court disagreed, holding that the agent had no duty to disclose "irregularities, illegalities, or acts of fraud in the loan transaction." Missouri also ruled that an escrowee has no duty to disclose possible fraud.[105] The insurer-escrowee was sued for failing to advise the insured that the seller was defrauding him. The seller apparently altered the deed after closing so that the insured obtained title to a different unit in the same condominium than the one the insured had wanted. The court found that the fiduciary duty of an escrowee is limited, and "did not encompass a duty on the part of defendants to protect plaintiff from the acts of" the seller.

Of course, an escrowee violates its limited agency duties by actively participating in a fraud of one party on the other.[106]

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[102] 264 Cal.App.2d 160, 70 Cal.Rptr. 378, 380, (1968). *Lee* relied on *Blackburn v. McCoy*, 1 Cal.App.2d 648, 37 P.2d 153 (1934), ruling the same way on essentially the same facts.

[103] 349 So.2d 43 (Ala.1977).

[104] 901 F.Supp. 1122 (M.D.La. 1995).

[105] *Gilmore v. Chicago Title Ins. Co*., 926 S.W.2d 695 (E.D. Mo. 1996).

[106] *Baker v. Stewart Title & Trust of Phoenix, Inc.*, 5/2/00, 2000 WL 518802 (Ariz.App.Div. 1); *United Homes, Inc. v.*

b) Arizona and Nevada Rule on Duty to Warn of Fraud

Some states have said that an escrow officer has a duty to disclose to one party that the other is perpetrating a fraud in the transaction. A legal encyclopedia, Corpus Juris Secundum, says this:

> [T]here is no duty to disclose information received by an escrow agent unless such duty is required by the terms of the escrow agreement, or unless an agent knows that fraud is being committed on a party to the escrow.[107]

A Florida Appeals Court broadly hinted that an escrowee has a fiduciary duty to advise an escrow party when it knows that the other party intends to take unfair advantage.[108]

Arizona requires the escrow officer to report facts that suggest to the escrow officer that a fraud is being perpetrated. The duty-to-disclose-fraud rule was first adopted in Arizona in *Berry v. McLeod*.[109] In *Berry*, the broker arranged to have the seller convey to a shell corporation controlled by the broker. The broker then immediately resold the property to a third party for double the amount. The escrowee was alleged to have knowledge of the scam because the broker had asked to set up a back-to-back escrow. Unlike the California *Lee* case also involving a flip, the intermediate owner was a broker and the agent of the seller. The flip transaction violated the broker's duty of loyalty to the seller. The *Berry* court reviewed the California decisions and found the facts in *Berry* to be more threatening:

Moss, 154 So.2d 351, 354 (Fla.Dist.Ct.App. 1963); and *Bardach v. Chain Bakers, Inc.*, 265 A.D. 24, 27, 37 N.Y.S.2d 584, 587 (1942), aff'd 290 N.Y. 818, 50 N.E.2d 233 (1943).

[107] 30A C.J.S. Escrows § 10.

[108] In *Askew v. Allstate Title & Abstract Co.*, 603 So.2d 29 (Fla.App. 1992), the facts were that when the seller signed the purchase contract,

"he orally objected to the real estate broker about a subordination provision in the contract. The broker told appellant that the provision could be deleted. Although other changes to the contract were handwritten in, the subordination provision was not removed and appellant signed the contract containing the provision. Later, at the closing, in the presence of appellee's agent, appellant expressed concern to Howard about the subordination provision. Howard assured appellant he did not plan to implement the provision and would notify him if he did so. In fact, Howard knew that another closing that same day would create a mortgage on the property senior to appellant's mortgage. It is alleged that appellee's agent also knew of this other closing."

The court stated:

"Where the title insurance company is acting as closing agent, this court has stated in dicta that the agent also has a duty, as noted above, to both the buyer and the seller to properly supervise the closing. Gerson v. Broward County Title Co., 116 So.2d 455 (Fla. 2d DCA 1959). In this regard, the title agent has a fiduciary duty to both the buyer and the seller, two potentially conflicting parties. While a fiduciary may undertake to represent potentially conflicting interests, where an actual conflict arises, as it did here, the fiduciary's duty is to withdraw from the representation, not to disclose as was argued by appellant. See Conflict of Interest in Real Estate Closing, 68 A.L.R.3d 967, 976 (1976). As observed above, however, we need not reach this issue in our disposition of this appeal."

603 So.2d at 31.

[109] 124 Ariz. 346, 604 P.2d 610 (1979).

> The California rule on disclosure by an escrow agent is sound up to a point. Absent fraud, the activities of real estate investors and speculators in buying and selling real property is a legitimate activity. The escrow agent has no duty to regulate the transactions so that each party receives a fair price for his property. The escrow company is not a guardian for the uninitiated. On the other hand, the escrow agent should not assist the perpetration of fraud by silence when disclosure could prevent the accomplishment of the fraud.
>
> Generally, there is no duty to disclose information received by an escrow agent unless such a duty is required by the terms of the agreement, but we hold that there is an exception to the foregoing rule when the escrow agent knows that a fraud is being committed on a party to an escrow and the failure of the escrow agent to disclose the information of the fraud will assist in accomplishing the fraud; under such conditions the escrow agent has a duty to disclose the facts actually known.[110]

Berry was expanded in the case of *Burkons v. Ticor Title Ins. Co. of California*[111] In *Burkons*, and the companion case of *Manley v. Ticor Title Ins. Co. of California*,[112] Pyramid I bought land from various individuals, who took back deeds of trust. Pyramid signed letters of intent which gave the impression it would be constructing commercial buildings. Based on these letters, the sellers agreed to subordinate their deeds of trust to later deeds of trust obtained by Pyramid. In fact, the proceeds of the later loans were used to fund the down payments to the sellers, with the balance paid to Pyramid. None of the money was used for construction. When Pyramid defaulted, the subordinated sellers sued the insurer-escrowee for failure to disclose fraud per *Berry*.

The insurer argued that, under these facts, there was no fraud apparent to the insurer from its own escrow actions. It posited that the sellers were suggesting a duty to discover fraud rather than disclose fraud already known to the escrowee. The court disagreed:

> Berry requires the escrow agent to disclose information when it "knows that a fraud is being committed." Berry, 124 Ariz. at 352, 604 P.2d at 616. It does not require the escrow agent to investigate and search for fraud. Id. But our reading of Berry also leads to the conclusion that it does not permit the escrow agent to close its eyes in the face of known facts and console itself with the thought that no one has yet confessed fraud. Although not required to investigate, when the agent is aware of facts and circumstances that a reasonable escrow agent would perceive "as evidence of fraud," then there is a duty to disclose.[113]

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[110] 124 Ariz. 346, 604 P.2d 610, 616 (1979).

[111] 813 P.2d 710 (Ariz. 1991).

[112] 798 P.2d 1327 (Ariz.App. 1990). The *Burkons* case contains most of the legal analysis. *Manley* cites to *Burkons*.

[113] Id. at 718.

The court was influenced by the escrowee's internal directives and training which warned against insuring over-encumbered property. The training specifically described the Pyramid style of transaction, and labeled it "fraud." The escrow officer identified the Pyramid deals as being in the suspect category.

Thus, the *Burkons* court found liability because the insurer-escrowee was aware of the type of fraud at issue, and an employee had spotted that *modus operandi* in the transaction at issue.

Nevada recently adopted the *Berry* and *Burkons* standard, in *Mark Properties, Inc. v. National Title Co.*[114] The Nevada Supreme Court chose to side with Arizona rather than California on the issue. However, the court emphasized that an escrowee is not required to investigate, only to inform:

> We agree with Mark Properties that an escrow agent has a limited duty to disclose facts concerning actual fraud of which the agent is actually aware. Although we conclude that the escrow agent has such a duty, we hold that an escrow agent has no duty to investigate circumstances surrounding a particular sale in order to discover fraud.

In addition, the court found that the escrowee had no duty to warn a person of fraud when that person was not a party to the escrow.

c) How to Disclose Possible Fraud

The courts have spent much time analyzing whether or not there is a duty to disclose fraud, but little time explaining how the escrow officer would go about providing that information. Written disclosure is preferable, because it can be proven later and everyone can see exactly what was disclosed. The escrow officer should be very careful not to make slanderous statements.

The disclosure may be made in the title insurance commitment, even if the buyer does not actually see the commitment. In *Burman v. Richmond Homes Ltd.*,[115] the title insurer-escrowee was not liable for fraudulent concealment when its title commitments showed the defect. A developer failed to tell lot purchasers that the subdivision was in a special taxing district that made the lots liable for extra taxes. The buyers sued the insurer-escrowee, saying that it had aided the developer in concealing this fact. The insurer-escrowee won, because it showed the existence of the tax district in its title commitments and policies. The developer had not shown the title commitments to the lot buyers. The insurer had no duty to make sure the purchasers saw the commitments.

[114] 2000 WL 1839216 (Nev. 2000).

[115] 821 P.2d 913 (Colo.App.1991).

7) Appendix

( ) Resignation. Escrowee may, at any time, resign by serving written notice on the principals. Such resignation shall become effective 20 days after service of such notice, or on appointment of a Successor Escrowee, whichever occurs first. Principals may appoint a Successor Escrowee, to whom Escrowee shall assign, convey or transfer its rights and obligations under these instructions. Every Successor Escrowee shall become fully vested with all the title, estate, rights, powers and trusts, and shall be subject to the duties and obligations, of Escrowee. A Successor Escrowee shall not be responsible for any actions or failure to act of Escrowee.

( ) Disputes Over Duties of Escrowee. In the event of any reasonable dispute or question as to the duties of the Escrowee hereunder, the Escrowee shall be entitled, at its option, without liability to any person, to do any of the following:

(i) Refuse to perform any act other than to retain any deposits until it has received an acceptable written release from the principals; or

(ii) Comply with or seek a court order instructing Escrowee as to its rights and obligations hereunder.

The parties expressly agree that you, as escrow holder, have the absolute right at your election to file an action in interpleader requiring the parties to answer and litigate their several claims and rights among themselves and you are authorized to deposit with the clerk of the court all documents and funds held in this escrow. In the event such action is filed, the parties jointly and severally agree to pay your cancellation charges and costs, expenses and reasonable attorney's fees which you are required to expend or incur in the interpleader action.

( ) Amendments. No amendment, modification, termination or waiver of these instructions or any provision hereof, and no consent to any departure herefrom, shall be effective unless the same is in writing and signed by the Party to be bound thereby. Any such waiver or consent shall be effective only in the specific instance and for the specific purpose for which given. No notice to or demand on any Party shall entitle such Party to any other or further notice or demand in similar or other circumstances.

( ) Notice. All notices to be given under this Agreement shall be in writing and served personally or by facsimile, regular mail or certified mail, return receipt requested. Delivery by regular mail shall be complete on deposit of the notice in a United States mailbox with proper postage affixed. All notices shall be sent to the parties at the addresses recited in these instructions.

( ) Counterparts. These instructions may be executed in counterparts, each of which shall be deemed an original and all of which shall constitute but one and the same instrument.