TITLE INSURERS ARE ENTITLED TO RECOVERY UNDER A VIRGINIA SETTLEMENT AGENT SURETY BOND

by Brian O. Dolan and Christopher R. Papile[*]

Too frequently, title insurance companies receive a notice of claim from an insured lender or borrower asserting that a settlement agent failed to record a deed of trust, failed to include the proper legal description, failed to obtain a necessary release of lien, etc. Situations like these typically are covered claims, requiring the title insurance company to step in and rectify the situation. Sometimes a title insurance company must pay off a prior lien or surrender the face value of a policy. Not surprisingly, therefore, a title insurer faced with a claim from an insured may want to explore ways to obtain recoupment. One available option for recoupment is to file a claim under the settlement agent's surety bond (the "Bond"), which settlement agents are required to maintain by VIRGINIA CODE § 6.1-2.19, *et. seq.*, the Consumer Real Estate Settlement Protection Act ("CRESPA"). Title insurance companies in Virginia have been successful in recouping from a CRESPA surety when its agent violated a duty in conducting the closing. This article discusses the legal basis for title insurance companies to obtain recovery under the Bond.

VIRGINIA CODE § 6.1-2.21(C) requires a settlement agent to comply with the applicable requirements of CRESPA and its "licensing authority."[1] Moreover, VIRGINIA CODE § 6.1-2.21(D) requires a settlement agent to maintain a Bond "to the satisfaction of the appropriate licensing authority." CRESPA does not define, limit or restrict the scope of the Bond. Nor does it limit coverage to CRESPA violations. The statute likewise is silent as to the obligees or beneficiaries of the Bond. Instead, VIRGINIA CODE § 6.1-2.25 provides that the licensing authority may issue rules, regulations, and orders to carry out the provisions of CRESPA. Thus, the General Assembly vested the licensing authority with full power to establish the specific terms of the Bond, including identifying the parties and defining the rights protected by the Bond. Exercising that grant of authority, the Bureau of Insurance, a division of the State Corporation Commission, mandated specific language to be used for each Bond. Accordingly, the language of the Bond determines whether a title company is entitled to recover from the surety.

The Bond language mandated by the Bureau of Insurance states that the surety is bound to "***any*** aggrieved person who may be injured by the Principal as hereinafter provided. . . ." (Emphasis added.) In addition, the Bond requires settlement agents to act "in full compliance with the provisions of the laws of the Commonwealth of Virginia and rules, regulations, and orders prescribed by the Virginia State Bar and the State Corporation Commission pertaining to Settlement Agents." The plain language of the Bond requires compliance with *all* laws of the Commonwealth, not just CRESPA. This includes the common law as well as statutes such as the Wet Settlement Act, VIRGINIA CODE § 6.1-2.10, *et seq*., pursuant to which "the settlement agent shall cause recordation of the deed, the deed of trust, or mortgage or other documents required to be recorded and shall cause disbursement of settlement proceeds within two business days of settlement." VA. CODE § 6.1-2.13. The Wet Settlement Act further provides that "any persons suffering losses due to the failure of [] the settlement agent to cause disbursement as required by this chapter, shall be entitled to recover, in addition to other actual damages . . . reasonable attorneys' fees incurred in the collection thereof." VA. CODE § 6.1-2.15.

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[1] "Licensing authority" is defined in VIRGINIA CODE § 6.1-2.20 as the State Corporation Commission, the Virginia State Bar or the Virginia Real Estate Board.

Neither the Bond, CRESPA, nor the Virginia State Bar or State Corporation Commission rules, regulations and orders define the term "aggrieved person." BLACK's LAW DICTIONARY defines an "aggrieved person" as a party that has "a burden or obligation." BLACK's LAW DICTIONARY 60-61 (5th ed. 1979). Moreover, CRESPA defines a "person" as "a natural person, partnership, association, cooperative, corporation, limited liability company, trust or other entity." No provision of the Bond or applicable law precludes a title insurance company from being an "aggrieved person." Accordingly, a title insurer is an aggrieved person under the Bond and entitled to a distribution of proceeds from the Bond.

One surety, however, has recently succeeded in challenging the right of a title insurance company to obtain payment under the Bond, arguing that CRESPA does not create a private right of action. *Chicago Title Ins. Co. v. Main Street Title & Escrow, LLC*, CL 2008-7406 (Fairfax County, Va. 2008), *appeal dismissed as premature*, No. 090466 (July 28, 2009).[2] In *Main Street Title*, the court did not specifically address the above arguments. Instead, it adopted the ruling of Judge McGrath in *Koschene v. Hutchinson*, 73 Va. Cir. 103 (Frederick County, Va. 2007).

In *Koschene*, the settlement agent paid off the incorrect loan of the seller, one secured by a different piece of property. 73 Va. Cir. at 103-04. After discovering the error, the seller filed suit against the settlement agent. *Id.* at 104. The court granted the defendant's demurrer, in part, on the basis that CRESPA did not imply a private cause of action. *Id.* at 105. Importantly, though, the court overruled the demurrer in part, finding that the seller stated a viable cause of action under the Wet Settlement Act and for common law breach of a fiduciary duty. *Id.* at 106. The ability of a title insurance company to recover under a settlement agent bond was not an issue in the case. In recognizing that the plaintiff had causes of action against the settlement agent for violating the Wet Settlement Act and common law fiduciary duties, however, the opinion supports the position that a title insurance company is entitled to recovery under the Bond.

In *First American Title Insurance Company v. Western Surety Company*, 1:09-cv-403, 2009 U.S. Dist. LEXIS 44231 (E.D. Va. May 27, 2009), the District Court held, contrary to the decision in *Main Street Title*, that a title insurer had a cause of action against a surety and that it was an aggrieved person under the bond. The case arose after a settlement agent's employee diverted funds from a refinance loan. As a result, the insured lender's deeds of trust were in third and fourth priority, behind the prior deeds of trust. *Id.* at *1-*2. After paying the insured lender's claim and also obtaining a judgment against the settlement agent, the title company submitted a claim under the settlement agent's surety bond. The surety refused to pay, prompting the title company to file suit against it. *Id.* at *2. The surety moved to dismiss the case on the basis that a title company could not bring suit against it because CRESPA does not create a private cause of action. *Id.* at *3. The District Court rejected that argument. The court reasoned that in Virginia, a statute must plainly manifest the General Assembly's intent to abrogate the common law. Although CRESPA only allows the state licensing authority to bring actions for statutory violations of CRESPA, the statute contains no express statement or indication that it was intended to abrogate the common law. Therefore, title insurers may proceed against the bond for common law claims. *Id.* at *4-*5. The court also found that the title company was an "aggrieved person" under the bond. *Id.* at *6-*8.

Furthermore, regardless of whether a title insurance company is an "aggrieved person" under the Bond, a title insurer would be subrogated, under the well established doctrine of subrogation, to the rights of its insured as an aggrieved person under the Bond.[3] Virginia courts have liberally applied subrogation

[2] *Main Street Title* reached the opposite conclusion from *First American Title Ins. Co v. Classic Title & Escrow, Inc.*, No. 2008-7383 (Fairfax County, Va. 2008), creating a split within the circuit.

[3] In *First American Title*, after concluding that the title company had standing to pursue a common law breach of contract action against the surety, the District Court also allowed a claim asserting subrogation rights to proceed to discovery. 2009 U.S. Dist. LEXIS 44231, at *8 n.1.

for many years to place the party paying the obligation of another in the shoes of the obligee that received payment. *Fed. Land Bank v. Joynes*, 179 Va. 394, 402, 18 S.E.2d 917, 920 (1942) ("Virginia has long been committed to a liberal application of the principle of subrogation. . . . In no other jurisdiction has the doctrine been more firmly adhered to or more liberally expounded and applied, to meet the exigencies of particular cases, than in Virginia"). The doctrine of subrogation provides that "[w]henever one person is compelled to pay a debt or discharge an obligation *for which he is only secondarily liable, in person or in property*, and hence has *recourse over against the person or the property primarily liable*, for exoneration or contribution, a court of equity will subrogate the person thus secondarily liable to the position of the *creditor whom he has satisfied*, as to every *lien, preference or other special advantage* possessed by the latter at the time of such payment." *Thompson v. Miller*, 195 Va. 513, 519-20, 79 S.E.2d 643, 647 (1954) (emphasis in original) (citation omitted) (sureties who paid a corporation's debt were subrogated to the position of the mortgagee bank).

As a result of a settlement agent's breaches of duties owed to a title insurance company's insureds, the title insurance company may discharge the settlement agent's obligation to them in order to secure first priority lien positions for their insured deeds of trust. Under the long established doctrine of subrogation, a title insurance company is subrogated to the insureds' rights against the settlement agent, who is the Principal named in the Bond.

Moreover, VIRGINIA CODE § 38.2-207 expressly establishes a title insurance company's right of subrogation in this scenario. It provides, in relevant part:

> [w]hen any insurer pays an insured under a contract of insurance which provides that the insurer becomes subrogated to the rights of the insured against any other party the insurer may enforce the legal liability of the other party. This action may be brought in its own name or in the name of the insured or the insured's personal representative.

Standard American Land Title Association ("ALTA") loan policies specifically provide for the title insurer to be subrogated to the rights of the insured. For example, ALTA Loan Policy (10/17/92), paragraph 12(a), entitled "Subrogation Upon Payment or Settlement," provides:

> Whenever the Company shall have settled and paid a claim under this policy, all right of subrogation shall vest in the Company unaffected by any act of the insured claimant. The Company shall be subrogated to and be entitled to all rights and remedies which the insured claimant would have had against any person or property in respect to the claim had this policy not been issued.[4]

Likewise, VIRGINIA CODE § 8.01-13 notes that an assignee or "beneficial owner" of any bond may maintain an action in its own name against the obligor. The term "beneficial owner" includes a subrogee. *Nationwide Mut. Ins. Co. v. Minnifield*, 213 Va. 797, 799, 196 S.E.2dd 75, 77 (1973). This statute provides an additional basis for a title insurance company to obtain recovery under the Bond.

Several courts have recognized that the rights of subrogation apply to title insurance companies to the same extent they apply to other subrogees. In *In r`e Dameron*, 155 F.3d 718 (4th Cir. 1998), a title insurer paid the claims of its insured lenders arising from the misappropriation of settlement funds by an attorney settlement agent. The Court stated: "Old Republic issued insured closing letters to [the lenders] in connection with the four settlements at issue. When called upon to do so, Old Republic paid [two of the lenders] for their losses and thereby became subrogated to their rights in the funds." *Id.* at 721 n.4.

In *Spring Constr. Co. v. Harris*, 614 F.2d 374 (4th Cir. 1980), a title insurance company bonded off mechanic's liens and then defended mechanic's lien enforcement actions brought by subcontractors and materialmen. The title insurer settled the mechanic's lien claims and asserted a claim in a federal

[4] The 6/17/06 ALTA Loan Policy contains a similarly worded provision.

court proceeding against the owners. The general contractor took the position that the title insurer was not entitled to a recovery because of its voluntary settlement with the subcontractors. The Fourth Circuit Court of Appeals rejected this argument, stating that "[t]he right of LTIC to the funds in question in this case . . . is based upon the equitable rights of LTIC to the funds by reason of its subrogation to the claims of the subcontractors and materialmen against the properties after LTIC . . . had paid those claims." *Id.* at 379.

At least one Virginia state court has recognized a title company's subrogation rights. *See Lawyers Title Ins. Corp. v. P.R.T. Enters., Inc.*, 65 Va. Cir. 271 (Norfolk, Va. 2004) (title company purchased a judgment to clear title for its insured and became subrogated to the rights of the judgment creditor).

A title insurance company's insured lender is undoubtedly an aggrieved person under the Bond. A title insurance company, having made payments for the benefit of the insured lender or borrower, is subrogated to the insured's rights as an aggrieved party under the Bond. The VIRGINIA CODE and above cases make it abundantly clear that even if a title insurer were not an aggrieved person under the Bond in its own right, it would be subrogated to the rights of its insured and may pursue recovery in its own name against the surety.

Although CRESPA does not create a private cause of action for title insurance companies, the issue is whether title insurance companies have any cause of action against a bonding company that fails to comply with the terms of the surety bond. When settlement agents violate laws, rules, regulations, and orders, a title insurance company may have a cause of action against the sureties under the plain terms of the Bond. Should the surety refuse to pay a title insurance company's claim, it would be in breach of the terms of the Bond, and a direct common law breach of contract cause of action would exist against it.

In sum, CRESPA created supervision and enforcement rights in favor of the Commonwealth against settlement agents. CRESPA allows the licensing authority to establish the parameters of surety bonds. Under the terms of the Bond, the surety is held and bound unto any aggrieved person, including a title insurance company, injured by the Principal under the Bond. If the surety breaches its obligations under the Bond by refusing to pay a claim, a title insurance company has a direct cause of action against it, without needing to allege a CRESPA violation.

As a final point, denying a title insurance company's claim elevates form over function and delays the inevitable. Nothing prohibits insured lenders or borrowers from filing individual claims under the Bond and then reimbursing their title insurance company, or executing formal written assignments of their rights in favor of a title insurance company. In fact, under the usual title insurance policy each insured is required to do so upon its title insurer's request. Hopefully, in future cases, sureties will take the practical approach and not unnecessarily increase title insurance companies' costs by forcing each insured to submit individual claims or execute assignments.