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Having Title Insurance Can Be Absolutely Critical

In states where title insurance is the norm, attorneys would likely counsel their mortgage lender clients to make sure that they obtain title insurance on their mortgages. In New York, for example, the owner/borrower obtains a "fee policy," and the lender gets a "mortgage policy."

Although this may seem obvious, some lenders engage a title company they own, which tends to make the insurance illusory if called upon. For other lenders who may buy portfolios of mortgages, incredibly, there are instances where the title policy was never obtained or where it just didn't accompany the file and cannot be located - a dilemma more acute when the assignor of the mortgage is no longer in business.

This exploration of what should be apparent is elicited from a bizarre New York case in 2002, Marcus Dairy v. Jacene Realty Corp., where a lender really got burned - except that title insurance was there to offer rescue.

In many states, when a borrower seeks a mortgage, it is usual that the lender will insist upon a title policy to protect the mortgagee. Because a title (or abstract) company has performed a search of the public records, one might assume there is little room for defects which could surface to harm the lender.

But such is not at all the case in the real world. There are hidden title flaws that the title company

might never be able to find. Or their title readers could simply make mistakes. They are human, after all, and some do not do their jobs as well as others. And then there are judgment calls the title company makes which may just prove to be wrong. The latter category is the one which created a mess for a lender in the noted case (with worse consequences to the title company).

Here are the facts. Jacene gave a mortgage to the dairy and later defaulted, with the dairy expectedly responding by instituting a mortgage foreclosure action. The borrower defended, resulting in dismissal of the complaint, vacating of the lis pendens and a directive that the mortgage be cancelled and discharged of record - all quite a loss for the foreclosing lender.

Although the judgment directing all this was entered in the county clerk's office, it was never recorded in the division of land records. So, the mortgage was not cancelled on record (even though it was what the court had decreed).

The plaintiff, not surprisingly, appealed the unpalatable judgment and sought a stay of the discharge of its mortgage. The motion, however, was denied. Borrower Jacene later conveyed the property to one Melissa Thomas, who then went and obtained a mortgage from a new lender. The title insurance company for the new lender found the dairy's mortgage open in the division of land records, but was willing nevertheless to insure - both because of the supreme court judgment in the case directing that the mortgage be discharged and some sage case law in New York previously ruling that knowledge of an appeal does not take away the bona fide status of a purchaser of property.

In short, there seemed an apparent basis to assume that Thomas' title (from Jacene) was good and that a new mortgage would be valid.

But on appeal, the court reversed the initial judgment and reinstated the earlier dairy mortgage, which then engendered a new mortgage foreclosure action by dairy in which the new lender was named as a party defendant.

Unfortunately for the new lender (and again more so for its title company), the transfer of the property from Jacene to Thomas was for no consideration. Moreover, Thomas made material misrepresentations in her mortgage application. So, the court concluded that the new mortgage lender knew or should have known what the court found to be a fraudulent transfer of property.

Based on those facts, the court decided that the new lender could not get the protection of a bona fide purchaser and could therefore not avail itself of the helpful case law in New York previously mentioned.

In the end, the court found that the original mortgagee (the dairy) would have been devoid of any remedy if its mortgage was not found to be senior, while the new lender could turn to its title insurance company - which should have known better - and collect from them. Because the first mortgage lender would still have had an action on the debt even if its mortgage was junior, we are not so sure the court was entirely correct here, but that is an academic point.

The new lender (and that could have been almost anyone in the business) will be wiped out - except that the title company was there to step in. An ultimate lesson of all of this, for lenders at least, is that title insurance can be critical. Of course, lenders need a title insurance company that has the wherewithal to pay, if called upon.

That later mortgage loan was iffy. The title company took a business risk, and it turned out not to be a good one. The second lender, however, won't suffer by having taken a mortgage under what were apparently questionable circumstances. The title company was there to respond in damages.

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