OH, DO LENDERS NEED TITLE INSURANCE!*

** by Bruce J. Bergman

This missive may be too obvious – but we don't really think so. And it may even be more relevant to mortgage originators and underwriters than foreclosing mortgagees, but it still makes a very practical and dramatic point which enlightens most of us. [It all arises out of a rather bizarre late 2002 case: *Marcus Dairy v. Jacene Realty Corp.*, 298 A.D.2d 366, 751 N.Y.S.2d 237 (2d Dept. 2002)].

Certainly in New York, when a borrower seeks a mortgage it is usual that the lender will insist upon a title policy to protect the mortgagee. (The borrower, of course, purchases a fee policy for himself and the lender simultaneously requires issuance of a mortgage policy.) Because a title (or abstract) company has performed a search of the public records, the initiated might assume there is little room for defects which could surface to harm the lender. But, as we know, such is not at all the case in the real world. There are hidden title flaws that the title company might never find. Or, their readers could simply make mistakes; they are human after all and some may not do their jobs as well as others. And then there are judgment calls the title company makes which might 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).

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Here are the facts. Jacene gave a mortgage to the Dairy, later defaulted, with the Dairy 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. Although the resultant judgment was entered in the county clerk's office, it was never recorded in the Division of Land Records and so the mortgage was not cancelled of record. The plaintiff Dairy appealed from the unpalatable judgment and sought a stay of the mortgage discharge but the motion was denied.

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 to insure because of the combination of the supreme court judgment directing that the mortgage be discharged and some sage case law in New York ruling that knowledge of an appeal does not take away the bona fide status of a purchaser of property.

As you might expect, on appeal the court reversed the initial judgment and reinstated the earlier mortgage which then engendered a new mortgage foreclosure action 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. (You've heard of those things before.) So the court concluded that the new mortgage lender knew or should have known of 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 not avail itself of the helpful case law in New York previously mentioned.

In the end (and in short) the court found that the original mortgagee would have no 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.)

An ultimate lesson of all of this – for lenders at least: title insurance is critical. That later mortgage loan here 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.