

An Overview of Closing Protection Letters for Title Insurance

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Background With real estate prices mired in the doldrums and borrowers walking away from their mortgage debts in record numbers, mortgage lenders have a lot of written-down assets on their hands. The FDIC, and those lenders that survived the recent crisis, have undertaken a campaign to recoup as many of these losses as possible through litigation against whoever remains solvent and can be tied to alleged mortgage fraud. Closing protection letters have proven an active object for lenders' efforts to spread their losses to title insurance underwriters. **What Is A Closing Protection Letter?** A closing protection letter (sometimes "insured closing letter" or "CPL") forms a contract between a title insurance underwriter and a lender, in which the underwriter agrees to indemnify the lender for actual losses caused by certain kinds of misconduct by the closing agent. Title underwriters often authorize closing agents to issue these letters to lenders when the closing agent anticipates issuing the underwriter's title insurance policies in the transaction. An ALTA form, various state promulgated forms, underwriter's own forms, and custom letters have all cropped up. Most letters explicitly make a third-party beneficiary out of the borrower in a purchase transaction. **What Does A CPL Usually Cover?** Typical closing protection letter provisions cover (1) failure to follow written closing instructions, to the extent that the instructions (a) affect the validity, priority, or enforceability of the mortgage lien, (b) require the closing agent to obtain, but not to vouch for the validity or effectiveness, of a specific document, or (c) relate to the collection of funds due to the lender; or (2) fraud or dishonesty in handling the lender's funds or documents. **What Other Significant Provisions Should We Be Aware Of?** The letter usually caps liability at the face amount of the title policy. Lenders must make their claims within a certain time (often within 90 days) of their loss. Some letters provide an absolute time limit (usually a year) from the time of closing for making a claim. The letter typically provides the underwriter with subrogation rights that it prohibits the lender from impairing. **What Are The Most Important CPL Issues And Cases?** Though these letters have been issued all around the United States for at least 40 years, the body of case law interpreting them remains remarkably small. But with expensively represented lenders aggressively pursuing these claims, significant new opinions are becoming more frequent. Here are the issues to be aware of and

the cases that cover them:

- **Standing.** The closing protection letter claim generally follows the loss, so that either an originating lender or a successor lender usually has standing to bring the claim if they have suffered any part of an actual loss. *JP Morgan Chase Bank, N.A. v. FDIC*, No. 09-14891, 2011 WL 2413438 (E.D. Mich. June 10, 2011); *GMAC v. Flick Mortgage Investors, Inc.*, No. 3:09-cv-125, 2011 WL 841409 (W.D.N.C. Mar. 7, 2011).
- **Closing Instruction Breaches.** Courts have properly limited CPL claims based on failures to follow closing instructions to (1) written instructions only, (2) only those types of instructions and types of duties that are actually spelled out in the CPLs provisions. *Federal Agric. Mortgage Corp. v. It's A Jungle Out There, Inc.*, No. C03-3721, 2005 WL 3325051 (N.D. Cal. Dec. 7, 2005).
- **Fraudulent Or Dishonest State Of Mind.** For liability to arise under the “fraud or dishonesty” provision, the closing agent must have acted with a subjective intent to deceive. *Lawyers Title Ins. Corp. v. New Freedom Mortgage Corp.*, 655 S.E.2d 269 (Ga. Ct. App. 2007); *Lawyers Title Ins. Corp. v. New Freedom Mortgage Corp.*, 645 S.E.2d 536 (Ga. Ct. App. 2007).
- **Loss Causation.** No matter how egregious a closing agent’s conduct, it gives rise to CPL liability only if it actually causes the monetary loss. *New Freedom Mortgage Corp. v. Globe Mortgage Corp.*, No. 274864, 2008 WL 3013400 (Mich. Ct. App. Aug. 5, 2008); *First Am. Title Ins. Co. v. Vision Mortgage Corp., Inc.*, 689 A.2d 154 (N.J. Super. Ct. App. Div. 1997).
- **Lender Misconduct.** A lender’s mere negligence in underwriting or closing the loan generally will not defeat a CPL claim, unless the lender’s misconduct undermines loss causation or impairs the underwriter’s subrogation rights. However, if the lender’s conduct solely caused the loss or the lender itself acted fraudulently or illegally, the underwriter should not be liable under the CPL. *Wells Fargo Bank, N.A. v. Old Republic Nat’l Title Ins. Co.*, 413 Fed. Appx. 569 (4th Cir. 2011); *Lawyers Title v. New Freedom Mortgage Corp.*, 654 S.E.2d 190 (Ga. Ct. App. 2007).
- **Actual Losses.** Some CPLs define actual losses to include only the lender’s settlement funds, but if they do not, then ordinary contract damages principles apply and the lender can recover any monetary loss it can prove with non-speculative evidence was actually caused by the breach, up to the face amount of the underlying title policy. *Capital Mortgage Assocs., LLC v. Hulton*, No. NNICV065000413S, 2009 WL 567057 (Conn. Super. Ct. Feb. 13, 2009); *First Am. Title Ins. Co. v. Vision Mortgage Corp., Inc.*, 689 A.2d 154 (N.J. Ct. App. 1997); *Herget Nat’l Bank of Pekin v. USLife Title Ins. Co. of N.Y.*, 809 F.2d 413 (7th Cir. 1987).

- **Timely Claim.** Some courts have strictly enforced CPL timely claim provisions, while others have grafted state law prejudice requirements into their late notice analysis. *JP Morgan Chase Bank, N.A. v. FDIC*, Case No. 09-14891, 2011WL 2413438 (E.D. Mich. June 10, 2011); *Primary Residential Mortgage, Inc. v. Guarantee Title Ins. Co.*, No. 4:05CV1115CDP, 2005 WL 2874663 (E.D. Mo. Nov. 1, 2005); *Federal Agric. Mortgage Corp. v. It's A Jungle Out There, Inc.*, No. C03-3721, 2005 WL 3325051 (N.D. Cal. Dec. 7, 2005).
- **Economic Loss Rule.** Tort claims based on the same conduct that supports a contract action under the CPL are usually barred by state economic loss rules. *Lehman Bros. Holdings, Inc. v. Hirota*, No. 8:06-cv-2030, 2007 WL 1471690 (M.D. Fla. May 21, 2007).
- **Underwriter As Insurer.** While some courts have applied typical insurance rules of construction to CPLs, others have recognized that the CPL itself is not insurance, and should be treated as an ordinary contract. *Lawyers Title v. New Freedom Mortgage Corp.*, 655 S.E.2d 269 (Ga. Ct. App. 2007); *American Title Ins. v. Variable Annuity Life Ins. Co.*, No. 14-94-01088-CV, 1996 WL 544431 (Tex. Ct. App. Sept. 26, 1996).

Conclusion CPL claims are on the rise. The CPL serves an important function in providing lenders with assurance that title agents will properly handle their funds and documents. However, it is important to understand that the CPL does not make the title insurance underwriter responsible for all types of errors that title agents may make. Thorough investigation of the facts of each claim, together with careful application of the existing body of CPL law, should be used to distinguish CPL claims that should be paid from those that should be denied.

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