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N.J. Ruling Impacts Underwriter Liability in Defalcations December 29, 2009

A title insurer can be liable for attorney theft of a homebuyer's funds if it fails to directly tell the client it is not responsible for any misdeeds, a New Jersey appeals court held recently.

Simply sending notice to the buyer's attorney is not enough, the Appellate Division said in *New Jersey Lawyers' Fund for Client Protection v. Stewart Title Guaranty Co.*, A-2622-07.

The court rejected the underwriter's argument that a disclaimer notice, included as part of the commitment packet sent to the closing attorney, can be imputed to clients who are victims of his theft.

Stewart Title plans to appeal the ruling, saying it departs from settled law.

"Through this decision, the Appellate Division has stated, for the first time, that a principal may be liable for the acts of an agent before the principal-agent relationship was created, or even before the principal and agent met, as was the case here," said attorney Jaimee Katz Sussner. "There is no question that this decision will have broad implications in a number of areas that the court did not likely intend. We strongly believe that this ruling was incorrect on many levels and will be overturned."

The court reinstated a complaint by two homebuyers against Stewart Title Guaranty Co. after their attorney Richard Pizzi allegedly stole money from the trust account. The theft was discovered when trust account checks bounced.

Pizzi was disbarred by consent in 2005 and the Lawyers' Fund for Client Protection awarded the Goodmans a total of \$307,456.47. The fund then moved to have Stewart Title reimburse its payout.

Mercer County Superior Court Judge Bill Mathesius dismissed the suit, finding Pizzi stole the Goodmans' money before he had contact with Atlantic Title Insurance Co., Stewart Title's agent.

But on appeal, Judge Jose Fuentes said a crucial part of the case against Stewart Title was that the disclaimer notice was just one document among the "multitude of papers" making up the title insurance commitment packet, and that the packet was only sent to Pizzi, not the Goodmans.

Stewart Title argued it was shielded from liability because Pizzi was the Goodmans' agent and service on him was sufficient to put them on constructive notice that the carrier would not be responsible for his malfeasance.

The appeals panel disagreed, citing *Sears Mortgage Corp. v. Rose*, 134 N.J. 326 (1993), where the justices ruled that in order to not be held liable for attorney misconduct, the title insurer must notify the homebuyer directly that it is not responsible.

"In *Sears*, the Court held that in order to nullify the agency relationship created when the title insurance company designates and empowers the closing attorney to deliver clear title to the insureds, the title company must notify the insureds directly that the title insurance policy will not cover any losses resulting from the attorney's misconduct," said Fuentes, joined by Judges Amy Piro Chambers and Michael Winkelstein.

"Here, the title insurer's disclaimer notice failed to sever this agency relationship because the notice was sent only to the attorney. Stated in more generic terms, a disclaimer by a principal intended to put a third party on notice that the principal does not assume liability for the malfeasance of its agent must be sent directly to the third party," he continued.

The requirement is needed because of the inherent conflict between the attorney and the title insurer. Fuentes added that since the carrier controls nearly all aspects of the closing, it is in the best position to ensure the buyer is kept fully informed about the status of the file.

"Thus, under *Sears*, defalcation committed by the buyer's attorney remains a risk covered under the title insurance policy, unless the title insurance carrier notifies its insured directly that the policy does not cover such risk," he said.

In the Goodmans' case, the insurer did not take the necessary steps to insulate itself against the risk of Pizzi's misappropriation. "The preferred and most effective method of service should include a signed verification from the client/insured acknowledging receipt of the notice," Fuentes wrote.

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The New Jersey Land Title Association argued amicus.

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