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Escrow Closing Mechanics

Are We Taking Too Many Risks?

By Lawrence A Kobrin and Timothy Gallagher

Not so long ago, the "closing" of a transaction — ranging from a simple one-family house transfer up to a complex commercial purchase — meant that all of the parties and all of their attorneys and advisers, the lenders and their counsel, and the title insurance company or companies would squeeze into a room, exchange happy or sad looks, and trade multiple documents. There were actual checks to be signed and handed over and by the magic of "gap" insurance, we took the risk that the title closer who gathered up all the papers would actually get them to the recording office before much time had expired or the facts changed.

At some point, New York practitioners heard of the development of a "California Style Closing," where both the funds and documents were deposited with the title company and when the title was cleared, the deposited documents were released, recorded and transmitted and the funds released to the correct parties.

New York practitioners resisted that kind of development for a long period of time. But with the passage of time, the developing complexity of our banking system, and the intervention of the Internet, New York has become California. Now, most closings are conducted through a depository intermediary, usually the title company. This article seeks to examine just what this development has brought us, and what new precautions practitioners should consider.

RISKS ASSOCIATED WITH A CALIFORNIA STYLE CLOSING

There are risks associated with implementing a California Style Closing in New York, which attorneys should keep in mind. Regulatory oversight for escrow agents in New York is minimal particularly when compared with escrow agents in California. In the latter state, both the title companies and licensed independent escrow companies are subject to strict regulatory oversight. Cal. Fin. Code, secs. 17200, 12389.6. They must use a separate trust account, similar to that required for attorneys in New York; keep records of escrow transactions; maintain adequate net

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worth; keep books and records available for inspection every two years; furnish audited financial statements; obtain fingerprints of all persons managing or participating in the escrow business; and deposit a bond with the commissioner. *Id.*, secs. 17210, 17404, 17405, 17348, 17406, 17202-06.

Unlike California, New York exempts title agents from insurance agent licensing requirements, and apparently does not otherwise regulate title agents or escrow agents. N.Y. Ins. Law § 2101(4). Unfortunately, escrow frauds are not uncommon in the state of New York. In 2010, the former president of Liberty Title Agency, a large independent title insurance agency, pleaded guilty to wire and insurance fraud. *United States v. Madden*, 09 CR. 799-01 RWS, 2011 WL 4359933 (S.D.N.Y. Sept. 19, 2011). Between 2008 and 2009, Brian Madden fraudulently misappropriated several million dollars from escrow and other client funds held by several title insurance agencies for his own personal enrichment, and conspired with others in the use of these funds.

The ability to seek enforcement of contractual and fiduciary duties of title agents to their beneficiaries is of little comfort and may take considerable time and litigation effort. As an example, *In re Galasso*, 19 N.Y.3d 688 (2012), took over eight years to resolve by litigation. In *Asher v. Herman*, 49 Misc.2d 475 (Supreme Ct., Qns Cty. 1966) an escrow agent embezzled the money placed in escrow by a vendee in a real estate transaction. The contract provided that the title would pass only when the Security Title and Guaranty Company approved and insured it. The vendees placed funds in the escrow, but the Security Title and Guaranty Company refused to approve and insure title. The court ruled that vendees owned the embezzled money at the time of loss and the loss fell upon them.

Given the low level of regulation and risks involved, what should practitioners do?

Who Is the Depository?

An initial question that should be considered by attorneys is just what entity is to be the depository for the closing funds and documents. If it is the national office of a recognized and well capitalized title company, that should be a source of reassurance. On the other hand, a local title agent of one of these companies may not provide the same level of comfort. Attorneys often prefer to use the individual representative of a title insurance company who operates through an independent agency and while that may be perfectly adequate for the retention of documents, it may not be so when very large amounts of money are involved.

Documentation

As transactions become more complicated, and larger, the casual informality of "we'll hold it in escrow" without formal documentation may be dangerous. Prudent practice would require the preparation, review, possible negotiation, and execution of a full and formal escrow agreement signed by both parties to the transaction and by the designated escrowee. One might wonder whether such a letter given by the title company would constitute an authorized and legal exercise of its power and not some inadvertent improper practice of law. That might depend on local circumstances.

Dispute Resolution

A critical part of the necessary escrow agreement must be the means by which a dispute is to be resolved. Routine attorney escrow agreements will often provide for an interpleader deposit in an appropriate court as a means to escaping the dispute, but this may not be a satisfactory provision where a title company, supposedly hired to review and certify the title, and possibly itself the source of the dispute, is the escrow agent. (*Asher v. Herman*, described above, is an illustration of the problem.)

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Consider the possible designation of a private dispute resolution procedure, such as AAA or JAMS, but consider something.

Multiple Title Companies

In very large transactions, more than one title insurer may be involved, as either a co-insurer or re-insurer. Consideration should be given to the relationship of the insurer holding the funds and documents and the other insurers. Who makes the decisions on whether the state of title is or is not satisfactory?

Fees

In smaller transactions, where an escrow closing is contemplated, the principal title insurer may provide the escrow services as a gratuitous accommodation. Where more complicated or prolonged effort is necessary, fees or expenses may be required. At the very least, even in a gratuitous situation, a title insurer will want indemnification for any out of pocket expenses, including its own attorney fees, which may be encountered. This should be spelled out and not left to the parties unspoken expectations or assumptions.

Deposit Accounts and Interest

At a time when normal bank deposits accrue almost nominal interest, it may seem silly to worry about interest accruals. But where the amounts are very substantial or the possibility of fund retention for any prolonged period of time may be expected, consideration and instruction must be given on whether an interest account is to be required. This raises the question on whether a separately maintained account should be required. Attorneys accepting escrow funds are subject to a variety of particular rules, including the need for a separate and noncommingled account, but are title companies? If a separate account is not required, how is interest to be computed, and who gets the interest if the transaction closes? Or if it does not?

Fund Disbursement

While online federal wire transfers of funds have become more prevalent and efficient, the occasional inefficiencies of the wiring process must be taken into consideration. This is particularly true in time sensitive closings (such as year-end or fiscal period end events) where wiring instructions are submitted to some central bank operations center, but are "caught in the pipeline" and not confirmed at the receiving end. Of course, it is easy to suggest that closings take place well in advance of any deadline, but that is often not the way these matters work out. Either the underlying contract itself, or the escrow agreement, should specify exactly what level of confirmation is needed to consider the transaction a completed one. Will receipt and advance of the federal wiring number be enough, or is something more required?

NY Fund Provides Limited Reimbursement

The New York Lawyer's Fund for Client Protection (Fund) provides only limited amounts to mitigate theproblems discussed while the Fund has been established to reimburse victims of escrow loss (The Fund's Mission, New York Lawyer's Fund For Client Protection, www.nylawfund.org/who.html (last visited July 22, 2013)); there is a $300,000 maximum limit per loss on awards from the Fund and its only protects against losses when attorneys act as the escrow agent.

Conclusion

Review the forms presented. Many law firms who deal regularly with large transactions involving such deposit closings have developed their own form of instruction and escrow agreement. The title companies themselves may have such forms, but any such proposed forms must be reviewed with some of the outlined considerations in mind.

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COOPERATIVES & CONDOMINIUMS

Appointment of Receiver

U.S. Bank National Association v. Sacher

NYLJ 5/16/13, p. 21, col. 1
Supreme Ct., N.Y. Cty.
(Jaffe, J.)

In a foreclosure action against a condominium unit, condominium board moved for an order appointing a temporary receiver for the unit. The court granted the motion over the foreclosing bank's objections, holding that the condominium was entitled to appointment of a receiver to rent the unit during the pendency of the foreclosure proceedings.

Unit owner took out two mortgage loans on the subject unit on Oct. 5, 2006, one for $455,000 and the second for $130,000. Unit owner defaulted in March 2007, and the bank, as assignee of the loans, brought this action to foreclose the first mortgage in June 2007. The bank moved for summary judgment, but in October 2007, Supreme Court denied the motion for failure to include an assignment from the original mortgagee and for failure to serve a notice at the proper address.

Mortgagee renewed its summary judgment motion in November 2009, but on Dec. 13, 2010, the court again denied the motion without prejudice upon proof of compliance with the Administrative Order of the Chief Administrative Judge relating to residential foreclosures. Meanwhile, unit owners have received a discharge in bankruptcy, and the current value of the premises is smaller than the amount of the first mortgage lien. On those facts, the condominium sought appointment of a receiver because due to failure of the bank to proceed on the foreclosure action, the size of the condominium board's lien has continued to grow, with no prospect of payment because the lien is subordinate to the bank's lien.

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