

Lender Voids Coverage by Self-Help and Settlement Without Notice

Republic First Bank v. First American Title Ins. Co., 2010 WL 5315979 (D.N.J.) (permanent citation not yet available).

A lender negated its policy coverage by taking a new mortgage to solve the possible infirmity of the insured mortgage, then settling with the bankruptcy trustee who attacked the later mortgage as a preference, all without the written consent of the title insurer and without waiting for it to solve the title defect.

Republic First Bank made a \$4.8 million loan to Oceans Below Properties, LLC in June, 2005 for the purchase of property in Toms River, New Jersey known as Pier One. The members of Oceans Below were Mitchell Deutsch and a partner. This was one of several loans the bank made to Deutsch and his entities, in what the court later called a "Ponzi-like scheme."

Pier One is made up of two adjoining parcels. One parcel was owned by Ernest Napolitano and the other by Double N, Inc., a company owned by Napolitano. At closing, Napolitano conveyed the parcel he owned individually to Oceans Below. He also sold the stock in Double N to Oceans Below. First American insured title and gave a markup to the bank.

However, no deed was signed at closing conveying the Double N parcel to Oceans Below. A month after closing, First American suggested that a confirming deed be recorded by Oceans Below, conveying the Double N parcel to Oceans Below. The deed was recorded.

In late 2006, Republic First agreed to take another mortgage on the Pier One property. It hired a different title company, which reported in its commitment that "although the Confirmatory Deed with regard to the Double N properties had been recorded, no specific deed for those tracts had been recorded." The bank did not "alert First American to this issue, and otherwise did not take any action to rectify the perceived problem." [First American later said that there was no defect in title after the recording of the confirming deed.]

Oceans Below defaulted on the Pier One loans. Republic First brought a foreclosure action. A third title company was hired, and issued a title search note saying that "the deed for the Double N tracts remains in Double N's name." Republic First filed a claim. Before First American could take any action, however, the bank got a new mortgage from Double N, whose stock was now owned by its borrower, Oceans Below. That mortgage was recorded on September 11, 2007.

Double N filed for bankruptcy on December 3, 2007, listing the Pier One parcel as its sole asset [despite its 2005 deed to its related entity, Oceans Below]. The trustee challenged the September mortgage as a preference. As the court

pointed out, the bank "had two mortgages on the same property—one mortgage with Oceans Below, if it was the deeded owner, and another with Double N, if it was the deeded owner. Oceans Below and Double N were both the corporate entities of Deutsch."

Republic First sued First American in February, 2008, in state court. The case was removed to federal court. The next month, the Double N bankruptcy trustee filed a motion in the Oceans Below foreclosure action to ask for approval of a settlement agreement in which the bank would pay the trustee \$150,000 in cash to drop his preference claim. First American objected, arguing that Double N did not own the land and that Republic First's 2005 mortgage was valid. Nonetheless, the court approved the settlement, Double N gave quit claim deeds, and the bank paid the trustee \$150,000.

The bank later sold Pier One for \$4.2 million. In its lawsuit against First American, the bank claimed that the insurer should pay it the difference between its loan amount and its resale price. First American argued that title was not defective, and that the bank frustrated its ability to defend title by taking the Double N mortgage and then settling with the trustee over that mortgage.

The court said it could skip both "the back story of the alleged Ponzi-like scheme" and the question of whether or not title was defective, to decide the case based on the bank's actions to fix title on its own.

... RFB's actions violated the terms of the policy, and caused its own losses, so that First American is not obligated under the insurance policy to pay for those losses. ... [W]hen RFB discovered ... the issue concerning the Double N deed, it filed a notice of claim with First American, alerting it to a potential problem. At that point, RFB had not suffered any loss regarding the alleged defect, as no third party had attempted to supplant its status as a first priority lien holder. Instead of waiting for First American to investigate and cure the problem, a week later, RFB took a mortgage on the Double N properties through the entity Double N, which was then wholly owned by Deutsch. ... On the one hand, RFB was attempting to recoup its loan to Oceans Below through the foreclosure of the Double N properties (and the entire Pier One properties), and on the other hand, it secured another mortgage in the exact same properties that it was foreclosing upon. This appears irreconcilable. At a minimum, it appears to be a violation of the title insurance policy, which requires the insured to cooperate with First National in the defense and prosecution of actions, or other efforts to establish title, and prohibits the insured from acting to hinder this right.

... Even though RFB thought that the lack of a deed transfer for the Double N properties back in June 2005 caused its interest in those properties to be insecure, its actions cut-off First American's right under the title insurance policy to resolve that issue before RFB actually suffered a loss resulting from the defect. Moreover, even if First American failed to timely undertake its obligations to cure any title defect, the insurance policy still required RFB to obtain consent from First American before settling any claim or suit. ... This is not a case where an insured repeatedly implores the insurance company to fulfill its obligations and the insured has no choice but to take its own corrective action due to the insurance company's apathy or bad faith. Instead, RFB took actions that it believed would protect its interests in a business relationship with Deutsch that was quickly going sour. Although RFB was free to do whatever it determined was necessary without regard to its obligations under the title insurance policy, it cannot now seek to hold First American liable under that insurance policy in the wake of its unsanctioned actions.

Congratulations to subscriber Robert Grundlock of Rubin, Ehrlich & Buckley, P.C., of Lawrenceville, New Jersey, counsel for First American, on this very useful ruling.