

2001

## The Real Estate Recovery Fund: Stewart Title Guar. Co. v Park, 2001

Roger Bernhardt

Golden Gate University School of Law, rbernhardt@ggu.edu

Follow this and additional works at: <http://digitalcommons.law.ggu.edu/pubs>

 Part of the [Property Law and Real Estate Commons](#)

---

### Recommended Citation

Bernhardt, Roger, "The Real Estate Recovery Fund: Stewart Title Guar. Co. v Park, 2001" (2001). *Publications*. Paper 395.  
<http://digitalcommons.law.ggu.edu/pubs/395>

This Article is brought to you for free and open access by the Faculty Scholarship at GGU Law Digital Commons. It has been accepted for inclusion in Publications by an authorized administrator of GGU Law Digital Commons. For more information, please contact [jfischer@ggu.edu](mailto:jfischer@ggu.edu).

**The Real Estate Recovery Fund:  
*Stewart Title Guar. Co. v Park, 2001*  
Roger Bernhardt**

*Stewart Title Guar. Co. v Park* (9th Cir 2001) 250 F3d 1249

Stewart Title Guaranty (Stewart) insured several lenders who lent money to property owners seeking to refinance existing loans through a mortgage broker (broker). The broker acted as escrow holder for the refinancings. As escrow agent, the broker was required to pay off the existing loans so that the new loans would be secured by first deeds of trust. On receiving the refinance funds for the escrow account, the broker embezzled the loan proceeds instead of paying off the existing liens. The title policy obligated Stewart to protect its insureds (the new lenders) against loss of priority. When the new lenders filed claims under the policies, Stewart paid off the senior liens, thus becoming subrogated to the rights of the new lenders.

As subrogee, Stewart sued the broker and obtained a default judgment exceeding \$1.2 million. When the broker failed to pay the judgment, Stewart applied to the state Department of Real Estate (DRE) for payment from the California Real Estate Recovery Fund (Fund) (Bus & P C §§10470–10481). When the DRE denied Stewart’s application, Stewart sought a court order directing payment out of the Fund. The district court denied Stewart’s claim.

The Ninth Circuit affirmed. The Fund exists to “protect the public against loss resulting from misrepresentation and breach of fiduciary duty by real estate brokers who are unable to respond to damage awards.” 250 F3d at 1252. To recover from the Fund, the applicant must be an “aggrieved person” within the meaning of Bus & P C §10471(a) and must have diligently tried to collect from all liable persons in the transaction. A California court has defined “aggrieved person” as a client of the defrauding broker or a member of the general public. Because Stewart Title was neither the broker’s client nor a member of the public, it had no direct right of recovery from the Fund. The court held (250 F3d at 1255):

The [Fund] is a limited fund of last resort created by the California legislature to protect members of the public who would otherwise have no recourse against unscrupulous real estate professionals. Title insurance companies were not intended by the California legislature to be “aggrieved parties” as that term is used in [Bus & P C §10471(a)].

Alternatively, Stewart argued that it was entitled to payment from the Fund as a subrogee of the aggrieved persons here (namely, the borrowers and new lenders). The court held that Stewart had no subrogation right because it was obligated under its policy to compensate the new lenders for their loss and, in turn, the new lenders were precluded from recovery from the Fund until they had pursued collection from all other liable persons. Once Stewart made the new lenders whole, there was no right of recovery to which Stewart could be subrogated. Thus, the DRE and the trial court properly denied Stewart’s claim for payment from the Fund.

►**THE EDITOR’S TAKE:** Had a private insurance carrier refused to pay on the grounds successfully asserted here by the State Recovery Fund, my guess is that it might have been held liable for bad faith denial of coverage. The Fund has put itself in the enviable position of refusing to pay the primary party because it has not yet gone after some secondary party, while also

refusing to pay the secondary party who compensated the primary party because it was not itself the primary party. Those are pretty formidable barriers to recovery from the Fund.

The first horn of the defense is pretty secure because statute clearly requires the primary victim to first seek recovery from “all other persons liable to the claimant in the transaction.” Bus & P C §10471(c)(7)(E). It is the second horn—that even a subrogee (who was not itself a wrongdoer) cannot qualify as an “aggrieved person”—that I regard as based more on policy than on a technical reading of the Real Estate Recovery Act.

Nonetheless, it is hard to understand how this could have happened without some negligence on Stewart Title’s part. It certainly should not have insured a lender’s lien priority unless it had sufficient control over the loan escrow as to make sure that the transaction was done correctly, *i.e.*, that the senior lien was satisfied, that there were no intervening liens, and that the new lien was properly recorded, as well as making sure that the loan funds were transmitted to the borrower. From the meager statement of facts in the opinion, it appears that none of these steps occurred.

Generally, title insurers don’t indemnify mortgage lenders until they are certain that an actual loss has really occurred. If the insured’s mortgage lien turns out to be in second position rather than first, you can bet that the title company won’t offer money until it has been established that this lower priority results in a cash loss to the lender. After all, even second mortgages sometimes get paid.

In this case, the loss was pretty obvious: It appears that the lenders got no lien at all on the properties (no mortgages seem to have been recorded, and even if they had, they were not supported by enforceable loans because the borrowers never received the funds). Nor, for the same reasons, could the lenders recover anything from the intended borrowers (except in the unlikely case that the loan broker was the borrowers’ agent, making them responsible for his conduct).

But what about all that fine print in the policy? Isn’t there a clause somewhere that requires the insured to seek recovery from the loan broker (or the Fund, as the broker’s insurer)? More interestingly, if no such clause is there now, will there be one as a result of this decision? Will title insurers require their insureds to exhaust their remedies against their brokers first (possibly paying the litigation expenses for such actions) before they themselves have to pay? And, if so, could that include proceeding against the Fund? After all, the collateral-source rule says that insurance coverage generally does not bar recovery from a tortfeasor or his insurer, unless the Fund Act language is treated as repealing that rule in this context. Because the title company cannot recover from the Fund as a subrogee, it makes sense for it to demand that its insured do for it what it cannot do for itself.

If title policies start to say such things, insureds may find themselves truly in a hard place: The Fund may say it won’t pay until after they have recovered from their title insurer, while their insurer may say that it won’t pay until after they have recovered from the Fund. Oh, the trouble crooked brokers make for us all! —*Roger Bernhardt*