

March 2012

Attorney Malpractice for Failure to Require Fee Owner's Title Insurance in a Residential Real Estate Transaction

Robin Paul Malloy

Mark Kaplow

Follow this and additional works at: <https://scholarship.law.stjohns.edu/lawreview>

Recommended Citation

Malloy, Robin Paul and Kaplow, Mark (2000) "Attorney Malpractice for Failure to Require Fee Owner's Title Insurance in a Residential Real Estate Transaction," *St. John's Law Review*. Vol. 74 : No. 2 , Article 4.
Available at: <https://scholarship.law.stjohns.edu/lawreview/vol74/iss2/4>

This Article is brought to you for free and open access by the Journals at St. John's Law Scholarship Repository. It has been accepted for inclusion in St. John's Law Review by an authorized editor of St. John's Law Scholarship Repository. For more information, please contact selbyc@stjohns.edu.

ATTORNEY MALPRACTICE FOR FAILURE TO REQUIRE FEE OWNER'S TITLE INSURANCE IN A RESIDENTIAL REAL ESTATE TRANSACTION

ROBIN PAUL MALLOY*

MARK KLAPOW**

INTRODUCTION

One of the most significant disputes among residential real estate lawyers today involves the need for fee owner's title insurance. In New York State, for instance, the dispute in practice varies by region. In the downstate and New York metropolitan areas, lawyers routinely require a home buyer to obtain a fee owner's title insurance policy. On the other hand, in northern, central, and western New York (including the cities of Syracuse, Rochester, and Buffalo) the practice is not to use fee owner's title insurance. This disagreement in practice, as demonstrated by New York State, is one that is repeated in communities across the country. The question it raises is whether a lawyer should obtain the protection of fee title insurance for a homebuyer. To this question we provide a simple and straightforward answer.

It is our contention that a lawyer commits malpractice in representing a home buyer if that attorney fails to require a fee

* Professor of Law and Economics, and Director of the Program in Law and Market Economy, College of Law and Maxwell School, Syracuse University. He is the author of seven books and over twenty law review articles on matters of real estate law and issues related to law and economics. He has developed and advocated this malpractice standard for more than five years in lectures to attorney groups and to students in his classes on Real Estate Transactions.

** A 1999 graduate of the Syracuse University College of Law with an undergraduate degree from Washington University in St. Louis. He currently serves as a judicial clerk for the Honorable Christine O. C. Miller of the United States Court of Federal Claims in Washington, D.C.

owner's commitment and policy of title insurance as part of the transaction. We believe that the only exception to this requirement is when the lawyer makes a full disclosure to the client of the risks of not being insured; gives explicit advice against proceeding without insurance; and obtains the client's consent and signature to this effect on a written document. Furthermore, we believe that this obligation may run to a third party non-client in certain situations.

In making our case we proceed in several steps. First, we briefly discuss the transformation of the residential real estate market from a local to a fully integrated national and international marketplace. Here we argue that one consequence of this transformation is the changing of the relevant point of reference governing the standard of care in the delivery of legal services. The new standards for practice are now set by super-regional and national communities rather than by local communities. Second, we discuss the general nature of the lawyer's role in the residential real estate transaction. We suggest that changing market conditions have modified the lawyer's role in these transactions and the point of reference for malpractice standards. Third, we examine the risks associated with title examination as a result of our public recording system. We show that some risks are known and yet incapable of being eliminated. Such risks can generally be covered by title insurance. Fourth, we discuss the three primary methods of title assurance that are used to reduce and clarify the risks of title examination in today's marketplace. In this context we explain the difference in liability rules applied to errors and omissions under each method of title assurance. Fifth, we further clarify the lawyer's duty to obtain fee owner's title insurance in a residential real estate transaction, and suggest that this duty may extend to non-clients in certain situations. Finally, we offer a proposal for a form that may be used by an attorney in those situations where the client refuses to obtain fee title insurance despite a firm recommendation to the contrary. A modification of this form is also suggested for situations in which one seeks to clarify and limit the potential for a duty to arise with respect to a non-client.

I. TRANSFORMATION OF RESIDENTIAL REAL ESTATE MARKETS

Residential real estate markets are no longer local. Rather than having countless individual local markets for real estate transactions, we now have a fully integrated market operating at the super-regional, national and international levels. This transformation away from local and toward a more fully integrated national market has enhanced the profitability of real estate related activities and has raised important implications for the practice of law. In particular, with respect to the standard applied to the quality of professional legal services, it has shifted the frame of reference for determining a minimal level of competence for the exercise of professional judgment.

In this section of the article, therefore, we will discuss several trends and practices which have influenced this transformation of real estate markets. We will suggest that this transformation raises the standard of practice required by all lawyers involved in real estate transactions to a higher level. Specifically, we argue that local standards no longer control title assurance and attorney malpractice matters. The proper standard of professional care in this area is now governed by super-regional and national legal standards. In developing this argument, we will discuss the general integration of real estate market activities, the reasonableness of standardized consumer expectations, and the implications of the emergence of the secondary mortgage market.

A. *Market Integration in General*

In order to fully understand and evaluate today's residential real estate market, it is first necessary to add a brief historical perspective on the development of that market. The transformation of the real estate market from a predominantly localized business into a national and international sector of commerce took place in the broader context of, and indeed was driven by, market integrations in other major industries.¹ New technologies, infrastructure development, and an international

¹ See ROBIN PAUL MALLOY & JAMES CHARLES SMITH, REAL ESTATE TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 729 (1998). See generally Michael H. Schill, *Uniformity or Diversity: Residential Real Estate Finance Law in the 1990s and the Implications of Changing Financial Markets*, 64 S. CAL. L. REV. 1261, 1265-71 (1991) (discussing the integration of the real estate market with capital markets generally).

sentiment of openness to trade made far greater gains from specialization in goods and services possible.² Major national industries, which had been provincial in nature since their inception, were forced to operate beyond regional and national boundaries in order to stay competitive.³ This dynamic also affected significant changes in the way ancillary industries did business.⁴ In fact, during a relatively short period of time in the second half of the twentieth century, the entire worldwide financial landscape was radically and irretrievably altered by these market integrations.⁵ During this time period, expanding markets for trade, enhanced methods of mass production, and changes in financial markets all helped to transform contract law and tort law.⁶ In the last twenty years, these same types of forces have been transforming basic real estate law.⁷

Prior to the late 1970s the residential real estate market, like many other industries, was highly localized.⁸ Rarely were national or international parties involved in a residential transaction at any level.⁹ Residential markets were comprised of three general segments: (1) saving by households and others, (2) lending by organizations and institutions, and (3) borrowing by prospective homeowners.¹⁰ Generally, local lenders (banks and savings and loans, collectively referred to as "lenders")

² See MALLOY & SMITH, *supra* note 1, at 731. See generally Jane Fraser & Jeremy Oppenheim, *What's New About Globalization?*, MCKINSEY Q., Mar. 22, 1997, at 168.

³ See MALLOY & SMITH, *supra* note 1, at 728; see also Ron Ashkenas, *Capability: Strategic Tool for a Competitive Edge*, J. BUS. STRATEGY, Nov. 1995, at 13.

⁴ See MALLOY & SMITH, *supra* note 1, at 728.

⁵ See *id.*

⁶ See *id.*

⁷ See *id.*; see also Schill, *supra* note 1, at 1285 (noting the dramatic changes in real estate law since the 1970s).

⁸ See Paula C. Murray & Beverly L. Hadaway, *Mortgage-Backed Securities: An Investigation of Legal and Financial Issues*, 11 J. CORP. L. 203, 204 (1986) (arguing that the local nature of mortgages created capital shortages that reflected a need for a secondary mortgage market); see also Jonathan R. Macey & Geoffrey P. Miller, *The Community Reinvestment Act: An Economic Analysis*, 79 VA. L. REV. 291, 305 (1993) (attributing the local nature of banks to technological constraints, legal prohibitions against bank expansion, and state banking rules).

⁹ See Murray & Hadaway, *supra* note 8, at 204.

¹⁰ See MALLOY & SMITH, *supra* note 1, at 725-27; see also Joseph C. Shenker & Anthony J. Colletta, *Asset Securitization: Evolution, Current Issues and New Frontiers*, 69 TEX. L. REV. 1369, 1389 (1991) (outlining the interaction between banks, borrowers, and depositors).

dominated the marketplace, collecting deposits from local residents and lending these funds to local borrowers.¹¹ During this time the interest rates to be paid to investors and charged to borrowers were heavily regulated by the government.¹² State usury law limits on interest rate charges kept mortgage costs stable and predictable.¹³ These regulations, coupled with the limited ability of banks to operate interstate, kept the real estate market provincial.¹⁴ Savers were content because their deposits were insured and they lacked more lucrative investment opportunities.¹⁵ Likewise, homebuyers were satisfied because mortgage rates were predictable and accessible.¹⁶ Finally, lenders were in good financial shape because government regulations provided a sure and easy profit on the money being lent.¹⁷

The residential mortgage lending market thus resembled the situation at the Bailey Building and Loan in Frank Capra's classic movie, *It's A Wonderful Life*.¹⁸ Local depositors provided the money that local lenders used to make mortgage loans to local homebuyers.¹⁹ The localized nature of these residential financing patterns tended to insulate real estate law, and thus real estate lawyers, from many of the pressures of changing

¹¹ See MALLOY & SMITH, *supra* note 1, at 725–27; see also Murray & Hadaway, *supra* note 8, at 204 (noting the limited geographic operations of savings and loans and their reliance on local funds to finance local housing).

¹² See generally Edward L. Pittman, *Economic and Regulatory Developments Affecting Mortgage Related Securities*, 64 NOTRE DAME L. REV. 497 (1989); see also Schill, *supra* note 1, at 1265–66 (discussing “Regulation Q,” which capped interest rates that savings and loans, and commercial banks could pay to depositors); Shenker & Colletta, *supra* note 10, at 1389–90 (discussing “Regulation Q”).

¹³ See MALLOY & SMITH, *supra* note 1, at 729. *But see* Carl Felsenfeld, *The Savings and Loan Crisis*, 59 FORDHAM L. REV. S7, S11 (1991) (arguing that state laws contributed to the instability of savings and loan institutions themselves).

¹⁴ See MALLOY & SMITH, *supra* note 1, at 729.

¹⁵ See Pittman, *supra* note 12, at 502; see also 4C PATRICK J. ROHAN, REAL ESTATE FINANCING § 31.02, at 31–10 (1999) (discussing the creation of government organizations like the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC) as devices to attract savings deposits).

¹⁶ See Pittman, *supra* note 12, at 502.

¹⁷ See MALLOY & SMITH, *supra* note 1, at 730–31; see also Shenker & Colletta, *supra* note 10, at 1389 (describing “spread banking” as a means of securing profitability by obtaining deposits at interest rates below the rates on loans).

¹⁸ *IT'S A WONDERFUL LIFE* (Liberty Films 1946).

¹⁹ See MALLOY & SMITH, *supra* note 1, at 730–31; see also Schill, *supra* note 1, at 1264–65 (discussing the system of mortgages originated by savings and loan institutions funded by local residents).

standards evidenced in other areas of the law.²⁰ For example, in the areas of contract and commercial law, expanding and integrative market activities were fueling passage of more uniform laws which were responsive to increasingly non-local market patterns.²¹

This easygoing and very local system of real estate financing started to come apart during the late 1970s.²² The driving forces behind this change were the sudden availability of new investment vehicles—which offered traditional household savers far higher returns than regulated passbook savings accounts—and the development of the legal and technical infrastructure needed to support a modern secondary mortgage market for indirect investment in residential real estate activities.²³ In the short run, Americans soon moved billions of dollars out of traditional lending institutions and placed their money with newly developed money market funds, such as Dreyfus liquid assets.²⁴ These funds provided relatively safe investments and interest rates of 17–19% at a time when regulated bank accounts were limited to rates closer to 3½%.²⁵ As household savers moved their money out of traditional lenders, these lenders began to develop a shortage of capital for new loans.²⁶ They also

²⁰ See Schill, *supra* note 1, at 1264, 1273–74.

²¹ See *id.* (noting the uniformity of laws in the area of commercial transactions as compared to real estate).

²² See MALLOY & SMITH, *supra* note 1, at 731; see also Shenker & Colletta, *supra* note 10, at 1389 (noting the traditional, straightforward role of banks prior to changes in the 1970s).

²³ See MALLOY & SMITH, *supra* note 1, at 731; see also Shenker & Colletta, *supra* note 10, at 1383 (discussing the various forces driving securitization). See generally 1 TAMAR FRANKEL, *SECURITIZATION: STRUCTURED FINANCING, FINANCIAL ASSETS POOLS, AND ASSET-BACKED SECURITIES* § 2.8, at 60–64 (1991) (outlining the circumstances contributing to the emergence of securitization).

²⁴ See MALLOY & SMITH, *supra* note 1, at 731; see also Macey & Miller, *supra* note 8, at 306 (noting the current trend of household savers relying less on traditional local banking services); see FRANKEL, *supra* note 23, § 4.6, at 136–38 (noting that technology and securitization are attracting investors away from banks). Money market funds are mutual funds that hold money market securities—debt instruments issued with original maturities of one year or less. See ROBERT W. KOLB, *PRINCIPLES OF FINANCE* 153 (1988).

²⁵ See Murray & Hadaway, *supra* note 8, at 204–05; see also ROHAN, *supra* note 15, § 3I.02, at 3I–14 (noting the higher interest rates offered by money market certificates).

²⁶ See MALLOY & SMITH, *supra* note 1, at 731; see also Shenker & Colletta, *supra* note 10, at 1390 (noting that banks relied less on the spread between deposits and loans for profits as they were becoming less important credit suppliers).

found themselves stuck holding billions of dollars of local mortgages with interest rates of 7–10% when market rates were as high as 22–24%.²⁷

B. *The Secondary Mortgage Market*

In response to this market disruption, major regulatory reform occurred in the early 1980s.²⁸ Many of the more restrictive government regulations on lending institutions were significantly relaxed or altogether eliminated.²⁹ The reforms gave lenders new powers to enforce due-on-sale clauses, to offer borrowers a diversity of mortgage products, and to create new higher-return investment opportunities for savers.³⁰ These regulatory reforms also propelled the emergence of the secondary mortgage market and forever transformed the residential real estate market.³¹ In 1970, there was no secondary mortgage market.³² By the late 1980s, there were literally hundreds of billions of dollars worth of secondary mortgage activity.³³ Today, secondary mortgage activity is close to a trillion dollars per year.³⁴

The modern secondary mortgage market has been responsible for keeping residential real estate markets liquid, reducing mortgage costs, and reviving the financial health of

²⁷ See Murray & Hadaway, *supra* note 8; see also Schill, *supra* note 1, at 1265 (noting that savings and loan institutions had difficulty generating profits while income was tied to long-term loans at low rates).

²⁸ See generally Robin Paul Malloy, *The Secondary Mortgage Market—A Catalyst for Change in Real Estate Transactions*, 39 SW. L.J. 991 (1986); see also Schill, *supra* note 1, at 1266 (discussing efforts by the Federal Home Loan Bank Board and Congress to deregulate savings and loan institutions in the 1980s).

²⁹ See Pittman, *supra* note 12, at 502; see also ROHAN, *supra* note 15, § 3I.02, at 3I-14 (noting steps taken by Congress to deregulate the banking industry).

³⁰ See MALLOY & SMITH, *supra* note 1, at 731; see also FRANKEL, *supra* note 23, § 2.4.6, at 40–41 (outlining the motivations for banks to securitize loans).

³¹ See MALLOY & SMITH, *supra* note 1, at 731–32; see also Michael H. Schill, *The Impact of the Capital Markets on Real Estate Law and Practice*, 32 J. MARSHALL L. REV. 269, 280 (1999) (arguing that capital markets will continue to impact the nation's real estate industry).

³² See Malloy, *supra* note 28, at 994; see also FEDERAL HOME LOAN MORTGAGE CORPORATION, PUB. NO. 67, *THE SECONDARY MARKET IN RESIDENTIAL MORTGAGES* 12 (J. Pheabus ed., 1983) [hereinafter FHLMC, *THE SECONDARY MARKET*].

³³ See Malloy, *supra* note 28, at 994; see also *Mortgage-Related Securities are Emerging as Serious Competition to Other Investment Vehicles*, 17 LAND USE DIG., July 15, 1984, at 1.

³⁴ See Malloy, *supra* note 28, at 994; see also *Shattering Traditions: What's Ahead in Housing Finance?*, 1 SECONDARY MORTGAGE MARKETS, Aug. 1984, at 2, 4.

many lending institutions.³⁵ The amount of money involved has served as an engine for dramatic change in the residential real estate market.³⁶ Most significantly, real property and mortgage laws have been pushed toward greater uniformity as lenders have turned their attention to the demands of distant and wealthy mortgage market investors, and away from the particular concerns of local borrowers.³⁷ Simply stated, the real estate business is no longer local because the money is no longer local.

To better understand the implications of the secondary mortgage market, one should know a little about its history. The precursor to the modern secondary mortgage market was developed during the Great Depression with two primary purposes in mind.³⁸ The first was to restore solvency to the nation's lending institutions.³⁹ This was facilitated by use of a variety of quasi-government entities that would buy and sell mortgages within a "closed" market designed to regulate and stabilize the money supply.⁴⁰ The primary participants in this early secondary mortgage market were local lending institutions that would bring their existing mortgages to these market entities for sale and, in turn, would buy back these mortgages or those of other lending institutions.⁴¹ In allowing for the purchase and exchange of existing, or seasoned, mortgages by lending institutions across the nation, early secondary mortgage market activity reduced the vulnerability of local institutions to

³⁵ See Malloy, *supra* note 28, at 994.

³⁶ See Schill, *supra* note 1, at 1272 (noting how the growth of the secondary mortgage market was "explod[ing]" in the period "[f]rom 1970 to 1984," and observing that the percentage of loans securitized was growing from 32% to 61%).

³⁷ See *id.* at 1268.

³⁸ See Malloy, *supra* note 28, at 992; see also National Housing Act of 1934, 12 U.S.C. §§ 1707-15z-11 (1994); OLIVER JONES & LEO GREBLER, THE SECONDARY MORTGAGE MARKET—ITS PURPOSE, PERFORMANCE, AND POTENTIAL 115-17 (1961) (explaining that Title III of the National Housing Act of 1934 authorized national mortgage associations to be chartered by the FHA for the purpose of encouraging primary mortgage lenders to invest in FHA loans).

³⁹ See Malloy, *supra* note 28, at 992-93.

⁴⁰ See *id.* at 993; see also JONES & GREBLER, *supra* note 38, at 34-39. These quasi-governmental agencies exerted their influence by buying and selling loans from their mortgage portfolios, thus affecting the availability of funds to lenders. In times of "tight money," for instance, these agencies would buy loans from lenders in order to provide lenders with cash for additional loans. When lenders had cash surpluses and few loan applications, these agencies would sell loans to lenders as investments.

⁴¹ See MALLOY & SMITH, *supra* note 1, at 743.

the risks of local economic recession, thereby promoting solvency.⁴² In other words, money could be “moved” into an area by simply arranging for the purchase of locally originated loans, providing the local lenders with additional cash to loan.

The second purpose of the early secondary mortgage market was to allow the federal government to exercise tighter control over the national money supply and, in theory, better manage the national economy.⁴³ The federal government thus acted as a major participant in the early secondary mortgage market.⁴⁴ When circumstances so dictated, the government, through entities such as Ginnie Mae and Fannie Mae, purchased mortgages from local entities to increase the aggregate supply of loanable funds.⁴⁵ At other times, the government would sell mortgages to local lenders in order to reduce the amount of money the lenders had on hand.⁴⁶ Thus, the lenders reduced their cash position when purchasing the mortgages.⁴⁷ This system was quite effective in allowing the government to have substantial control over the aggregate amount of liquidity in the economy.⁴⁸

In the decades since the system's inception, the secondary mortgage market evolved in order to remain current with the economic needs of its participants.⁴⁹ The regulatory reforms of the early 1980s, which created new investment opportunities for many Americans, also had the effect of dramatically expanding the size and importance of the secondary mortgage market.⁵⁰

⁴² See Malloy, *supra* note 28, at 994.

⁴³ See *id.* at 992–93.

⁴⁴ See MALLOY & SMITH, *supra* note 1, at 740–44; see also Raymond A. Jensen, *Mortgage Standardization: History of Interaction of Economics, Consumerism and Governmental Pressure*, 7 REAL PROP. PROB. & TR. J. 397, 397–434 (1972) (discussing FHLMC and FNMA efforts to develop standardized forms to facilitate the secondary mortgage market and attract new capital assets to the housing market).

⁴⁵ See MALLOY & SMITH, *supra* note 1, at 743; see also JONES & GREBLER, *supra* note 38, at 45–49.

⁴⁶ See Malloy, *supra* note 28, at 994; see also JONES & GREBLER, *supra* note 38 (explaining how the government controls the flow of cash within the secondary mortgage market).

⁴⁷ See *supra* note 40 and accompanying text.

⁴⁸ See *id.*

⁴⁹ See Malloy, *supra* note 28, at 995.

⁵⁰ See *id.*; see also MICHAEL T. MADISON & JEFFRY R. DWYER, *THE LAW OF REAL ESTATE FINANCING* §§ 2.01(1)–(3), 2.02(3)(a)–(d) (1981 & Supp. 1984); Diana G. Browne, *The Development and Practical Application of the Adjustable Rate Mortgage Loan: The Federal Home Loan Mortgage Corporation's Adjustable Rate*

The modern secondary mortgage market involves much more than the simple buying and selling of mortgages.⁵¹ Today, the broader goal of the modern secondary mortgage market is to encourage and enhance the flow of capital into real estate markets.⁵² This is accomplished by integrating real estate investments into broader national and international capital markets.⁵³

The emergence of the modern secondary mortgage market and the concomitant changes to the real estate markets in general have had an equally dramatic effect on the entities that do business in that field—particularly on the practice of law.⁵⁴ Through the buying and selling of mortgages and, more particularly, mortgage-related securities, the secondary mortgage market directs funds in and out of a variety of local real estate markets.⁵⁵ This means that lenders must now rely on the ability to sell their mortgages to maintain an adequate supply of loanable funds.⁵⁶ The mortgages they originate must therefore cater to the needs of distant investors rather than exclusively to the needs of the local home buyers.⁵⁷

Unlike homebuyers looking to acquire a piece of the "American Dream," investors are primarily concerned with

Mortgage Loan Purchase Program and Mortgage Loan Instruments, 47 MO. L. REV. 179, 179-83 (1982) (discussing the economic backdrop for the adjustable rate mortgage loan); Christopher Caswell, Comment, *The New Mortgages: A Functional Legal Analysis*, 10 FLA. ST. U. L. REV. 95, 95-102 (1982) (discussing the history of problems necessitating the development of modern mortgage instruments).

⁵¹ See Malloy, *supra* note 28, at 1000.

⁵² See *id.*

⁵³ See *id.*; see also *A Mortgage Exchange*, 18 LAND USE DIG., Feb. 15, 1985, at 2 (observing that a national mortgage exchange similar to the New York Stock Exchange has been proposed by the chairman and president of FNMA); Raymond S. Cahnman et al., *Coping With Risk in the Secondary Market*, MORTGAGE BANKING, June 1984, at 10, 12 (outlining hedging strategies that employ futures contracts to reduce risk in secondary market activities); John W. Labuszewski & James F. Meisner, *Controlling Mortgage Pipeline Risk*, MORTGAGE BANKING, Nov. 1983, at 45, 45-50 (discussing futures trading on the Chicago Board of Trade).

⁵⁴ See Schill, *supra* note 1, at 1273-74. Louisiana has adopted Article Nine (Secured Transactions) of the Uniform Commercial Code, but not Article Two (Sale of Goods). Some commentators have argued that the continued lack of uniformity in the law governing secured financing, caused by amendment and judicial interpretation, has made commercial transactions less efficient. See, e.g., F. Stephen Knippenberg & William J. Woodward, Jr., *Uniformity and Efficiency in the Uniform Commercial Code: A Partial Research Agenda*, 45 BUS. LAW. 2519, 2520-21 (1990).

⁵⁵ See Schill, *supra* note 1, at 1274.

⁵⁶ See *id.* at 1275.

⁵⁷ See *id.*

making predictable investments with a high degree of liquidity.⁵⁸ These same investors tend to punish jurisdictions whose laws or practices deviate far from national norms, or are generally unfamiliar, by simply avoiding them.⁵⁹ The investor's desire for predictability is primarily responsible for driving the once-localized and divergent real estate markets towards a higher degree of uniformity of legal forms and standardization of practices. For this reason, real property law has been and still is being modernized and standardized in the way that contract law was a generation ago.⁶⁰ As a result, the multi-billion dollar influence of the secondary mortgage market has transformed real property law and the real estate market. Consequently, the pressure for national standardization and uniformity of real property law has increased dramatically since the 1980s due to the need to expand and facilitate, rather than hinder, the activity of the secondary mortgage market.⁶¹

Increased standardization and uniformity have improved market efficiency; provided mortgage lenders with greater liquidity and profitability; and reduced mortgage costs for home buyers.⁶² More significantly, for purposes of this article, the secondary mortgage market, coupled with the regulatory reforms of the early 1980s, has essentially nationalized real estate practice.⁶³ Hundreds of billions of dollars now flow in and out of local, regional, national, and even international lending institutions into the secondary mortgage market.⁶⁴ The dominant players in this vast financial market now set the standards for mortgage loan originations and underwriting.⁶⁵ No local real estate market can operate effectively in ignorance of this new environment and, consequently, all real estate

⁵⁸ See *id.*

⁵⁹ See MALLOY & SMITH, *supra* note 1, at 744.

⁶⁰ See Schill, *supra* note 1, at 1280.

⁶¹ See generally Schill, *supra* note 1, at 1271-77 (detailing evidence of the integration of real estate credit markets with general capital markets).

⁶² See *id.* at 1296-97; see also 4 RICHARD R. POWELL, POWELL ON REAL PROPERTY § 37.05[4], at 37-31 (Patrick J. Rohan ed., 1995) (discussing the economic importance of a secondary mortgage market).

⁶³ See Malloy, *supra* note 28, at 991.

⁶⁴ See *id.*; see also GEORGE LEFCOE, REAL ESTATE TRANSACTIONS 452 (1993) (noting the huge amounts of money flowing through the secondary mortgage market).

⁶⁵ See Malloy, *supra* note 28, at 998 (discussing how private investors have rivaled the government's investment in the secondary mortgage market).

markets are now becoming fully integrated into a national and international financial network.⁶⁶

C. Other Trends and Consumer Expectations

The emergence of the secondary mortgage market has not been the only force driving the disintegration of localized real estate practice since the early 1980s. The increased nationalization and standardization of commercial activities that occurred in the middle of the twentieth century have spawned a growing number of multistate law firms and nationwide real estate companies over the last ten years, which are just now beginning to dominate in many markets.⁶⁷ More recently, the relaxation of federal regulations has led to the rise of interstate banking operations.⁶⁸ These trends have further encouraged uniformity in standards as a means to greater business efficiency and have "globalized" practice standards across state lines.⁶⁹ Today, national television advertising for mortgages and the rise of internet-based real estate listings and services have also helped standardize national business practices.⁷⁰ These market integrations have caused, and will continue to cause, the inherited, localized standards of yesteryear to be replaced by national standards of quality.⁷¹

Consumer expectations have also been altered by these market changes.⁷² The market integrations at the national and international levels have permanently altered consumer service expectations nationwide.⁷³ This is particularly true in the market for mass-produced residential real estate.⁷⁴ Here,

⁶⁶ See *id.* at 1018; see also Schill, *supra* note 1, at 1261.

⁶⁷ See generally James A. Newell & Michael R. Gordon, *Electronic Commerce and Negotiable Instruments*, 31 IDAHO L. REV. 819 (1995) (discussing the evolution of mortgage transactions from paper documentation to electronic documentation).

⁶⁸ See *id.* at 823.

⁶⁹ See Schill, *supra* note 1, at 1261.

⁷⁰ See Newell & Gordon, *supra* note 67, at 833.

⁷¹ See Schill, *supra* note 1, at 1265.

⁷² See generally William N. Eskridge, Jr., *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consonant with the Economic and Psychological Dynamics of the Home Sale and Loan Transaction*, 70 VA. L. REV. 1083 (1984) (discussing the inadequacies of the national real estate market).

⁷³ See generally Henry T. Greely, *Contracts as Commodities: The Influence of Secondary Purchasers on the Form of Contracts*, 42 VAND. L. REV. 133, 147-51 (1989) (detailing the benefits of nationally-standardized mortgage contracts).

⁷⁴ See *id.* at 146-49.

consumers expect that service and quality standards will be substantially similar wherever they may live.⁷⁵ The increased mobility of the general populace has also contributed to these inclinations.⁷⁶ Whatever the ultimate cause, the fact remains that consumers have come to expect national standards of practice, not a series of divergent or peculiar local standards.⁷⁷ The culmination of these various market changes, when combined with the financial market changes of the economy in general and the secondary mortgage market in particular, has changed the practice of real estate law.⁷⁸ Just as banking law, contract law, and securities law are not the same today as they were ten years ago, so too are real estate law and practice. These changes have resulted in the elimination of local real estate markets, fostering uniformity and standardization that have undermined the credibility of local standards of care in approaching title assurance problems in residential real estate transactions.

II. THE LAWYER'S ROLE IN THE RESIDENTIAL REAL ESTATE TRANSACTION

Given the many changes in the residential real estate market, we must now more closely consider the implications for the real estate lawyer. In many ways, the movement towards a more fully-integrated national real estate market has increased competition for the procurement of services, which has further driven the pressures for cost-cutting and greater efficiency.⁷⁹ For this reason, residential real estate transactions are increasingly accomplished with the assistance of real estate brokers, title companies, and escrow or closing agents, rather than attorneys.⁸⁰ This has raised serious concerns in the legal

⁷⁵ See *id.* at 148.

⁷⁶ See *id.*

⁷⁷ See *id.*

⁷⁸ See *id.* at 149.

⁷⁹ See Michael Braunstein & Hazel Genn, *Odd Man Out: Preliminary Findings Concerning the Diminishing Role of Lawyers in the Home-Buying Process*, 52 OHIO ST. L.J. 469, 470 (1991) (discussing the expectations that homebuyers have and the role lawyers play in shaping those expectations).

⁸⁰ See *id.*; see also Joyce Dickey Palomar, *The War Between Attorneys and Lay Conveyancers—Empirical Evidence Says “Cease Fire!”*, 31 CONN. L. REV. 423, 429 (1999) (noting the displacement of attorneys by lay providers in residential real estate transactions).

community as to the future role of an attorney in a standard residential transaction.⁸¹ In this environment, the lawyer is under added pressure and scrutiny to add value and expertise to the residential real estate transaction.⁸² This section of the article therefore explores the changing role of the lawyer in the residential real estate transaction by considering the typical services provided in such a transaction, the pressures of competition from non-lawyers, and the lawyer's role as transactional risk manager.

A. *The Lawyer's Role*

Most buyers of residential property enter the real estate market only a few times in their lives.⁸³ As a result, the lawyer must be prepared to guide the client, who usually has little or no market experience, through all phases of the transaction.⁸⁴ From the time the attorney is hired, and through the final post-closing performance, the attorney acts as a fiduciary of the client.⁸⁵ The client places his complete trust in the competence and integrity of the attorney whose superior knowledge is relied upon for advice, guidance, and expertise.⁸⁶

In a residential real estate transaction, the client's expectation is that the lawyer will ensure, first and foremost, that every aspect of the transaction conforms with the applicable requirements of law.⁸⁷ Compliance with applicable legal standards, after all, is the primary focus of an attorney's legal training.⁸⁸ The client will generally have little experience in dealing with the numerous other professionals who participate in the transaction.⁸⁹ Even the simplest residential transaction will likely involve brokers, title examiners, escrow agents, property appraisers, loan officers, insurance agents, land surveyors, inspectors, government regulators, and other

⁸¹ See Braunstein & Genn, *supra* note 79, at 475.

⁸² See MALLOY & SMITH, *supra* note 1, at 3-5.

⁸³ See *id.* at 34.

⁸⁴ See *id.*; see also KARL B. HOLTZSCHUE, HOLTZSCHUE ON REAL ESTATE CONTRACTS 1-29 to 1-30 (2d ed. 1994) (listing the steps through which an attorney should guide a home purchaser).

⁸⁵ See MALLOY & SMITH, *supra* note 1, at 36-37.

⁸⁶ See THOMAS D. MORGAN & RONALD D. ROTUNDA, PROFESSIONAL RESPONSIBILITY: PROBLEMS AND MATERIALS 73 (6th ed. 1995).

⁸⁷ See MALLOY & SMITH, *supra* note 1, at 34.

⁸⁸ See *id.*

⁸⁹ See *id.*

lawyers.⁹⁰ The client will expect the attorney to understand and explain the roles of these professionals, as well as confer, and where necessary, negotiate with them while diligently protecting the buyer's expectations.⁹¹ In sum, the lawyer must be the one person in the transaction who, at every step, is completely committed to the buyer's interests.⁹²

B. Competition from Non-Lawyers

Among the other professionals who are typically part of a real estate transaction, brokers, whatever their capacity, are clearly among the most influential parties.⁹³ Traditionally, the core of the broker's responsibility in helping a client buy or sell certain property has been in marketing and price negotiation.⁹⁴ Increased cost-cutting pressures and higher consumer expectations, however, have motivated brokers to extend the scope of their services to include basic contract completion and advice on matters such as mortgage financing, zoning, surveys, and title insurance.⁹⁵ These activities, it has been argued, border on the unauthorized practice of law.⁹⁶ Of additional concern to many in the legal community is that the broker's close working relationship with the buyer or seller can also have a significant influence on the closing of the transaction and the client's view of the value of hiring, or not hiring, an attorney.⁹⁷

⁹⁰ See *id.*; see also PAUL GOLDSTEIN, REAL ESTATE TRANSACTIONS—CASES AND MATERIALS ON LAND TRANSFER, DEVELOPMENT AND FINANCE 13 (1980) (listing the professionals and specialists who are typically involved in residential transactions).

⁹¹ See MALLOY & SMITH, *supra* note 1, at 34–36; see also Michael Braunstein, *Structural Change and Inter-Professional Competitive Advantage: An Example Drawn from Residential Real Estate Conveyancing*, 62 MO. L. REV. 241, 241 (1997) (explaining the role lawyers typically play in residential real estate conveyancing).

⁹² See MORGAN & ROTUNDA, *supra* note 86, at 87.

⁹³ See Ronald Benton Brown et al., *Real Estate Brokerage: Recent Changes in Relationships and a Proposed Cure*, 29 CREIGHTON L. REV. 25, 27–28 (1995) (noting the increasing number of brokers in the United States and their involvement on both sides of a traditional real estate transaction).

⁹⁴ See *id.* at 27 n.1 (citations omitted).

⁹⁵ See Michael K. Braswell & Stephen L. Poe, *The Residential Real Estate Brokerage Industry: A Proposal for Reform*, 30 AM. BUS. L.J. 271, 272 (1992).

⁹⁶ See MALLOY & SMITH, *supra* note 1, at 88–89; see also Gary S. Moore, *Lawyers and the Residential Real Estate Transaction*, 26 REAL EST. L.J. 351 (1998); R. Randy Lee, *Title Work and the Unauthorized Practice of Law*, 68 N.Y. ST. B.J. 16 (1996); R. Randy Lee, *The Limited Ability of Real Estate Brokers to Prepare Contracts*, 69 N.Y. ST. B.J. 32 (1997).

⁹⁷ See Paula C. Murray, *The Real Estate Broker and the Buyer: Negligence and the Duty to Investigate*, 32 VILL. L. REV. 939 (1987) (exploring the fiduciary duty

While effective brokers must know a good deal of basic real estate law and utilize it on behalf of their clients, brokers are strictly prohibited from the practice of law.⁹⁸ While the encroachments of brokers into areas that have traditionally been the exclusive province of lawyers have caused some tension and resentment, the most significant response has been charges of the unauthorized practice of law.⁹⁹ Of course, not every responsibility filled by an attorney constitutes the practice of law.¹⁰⁰ It is thus important to fully understand the breadth of this prohibition on non-lawyers.

In transactions where both seller and buyer have attorneys, the division of labor is usually reasonably clear.¹⁰¹ Brokers should bring the parties together, negotiate business terms, and assist the parties in preparing for closing by ordering inspections of the property and performing similar tasks.¹⁰² Lawyers should negotiate and draft the contract of sale, draft or review financing documents, and work on matters of title.¹⁰³ Many residential real estate transactions, however, involve at least one party who is not fully represented by counsel.¹⁰⁴ In these transactions, the

that a broker, who is generally the agent of the seller, may owe to both the buyer and the seller).

⁹⁸ See MALLOY & SMITH, *supra* note 1, at 88–90; see also *Duncan & Hill Realty, Inc. v. Dep't of State*, 405 N.Y.S.2d 339, 344 (4th Dep't 1978) ("The law forbids anyone to practice law who has not been found duly qualified and licensed to do so.").

⁹⁹ See MALLOY & SMITH, *supra* note 1, at 88–90; see also Braunstein, *supra* note 91, at 250 (discussing the legal profession's response to the increased role played by brokers, and the use of the unauthorized practice of law statutes to combat the encroachment of the attorney's traditional role).

¹⁰⁰ See, e.g., *In re Opinion No. 26 of the Comm. on the Unauthorized Practice of Law*, 645 A.2d 1344 (N.J. 1995) (holding that a real estate transaction conducted without an attorney present is not the unauthorized practice of law provided the broker gives notice of the conflict of interest).

¹⁰¹ See MALLOY & SMITH, *supra* note 1, at 51–54.

¹⁰² See *id.*; see also Katherine A. Pancak et al., *Real Estate Agency Reform: Meeting the Needs of Buyers, Sellers, and Brokers*, 25 REAL EST. L.J. 345, 346 (1997) (noting that the broker traditionally serves two important functions—provider of information about marketing the house, and representative in negotiating the sales terms).

¹⁰³ See MALLOY & SMITH, *supra* note 1, at 34–36. See generally Gary S. Moore, *Lawyers and the Residential Real Estate Transaction*, 26 REAL EST. L.J. 351 (1998) (exploring the proper roles for lawyers in a real estate practice and the varying local customs that impact whether lawyers are consulted before or after the contract or the closing itself).

¹⁰⁴ See MALLOY & SMITH, *supra* note 1, at 244; see also Braunstein & Genn, *supra* note 79 at 469–79 (reporting on a study of the lawyer's role in residential real

real estate broker or other non-lawyer professional is likely to provide the only source of guidance to the unrepresented party.¹⁰⁵

Various states have addressed this concern by taking different approaches to the problem of unauthorized practice of law by real estate brokers.¹⁰⁶ While there is no uniformity, most states now permit brokers and title companies to prepare standard-form contracts of sale for customers, or to fill in the blanks on some basic closing documents, at least in some circumstances.¹⁰⁷ In many states, the standard residential form contract of purchase and sale is approved by a bar association in conjunction with a broker's association.¹⁰⁸ The standard form also typically provides for a party to obtain a review by an attorney.¹⁰⁹ Working with a standard form contract, however, does nothing to ensure that one fully understands the legal and economic consequences of the terms expressed or implied by the document.¹¹⁰ This is where one comes face-to-face with not only

estate transactions and the effect of the availability of title insurance on the lawyer's involvement in the process).

¹⁰⁵ See MALLOY & SMITH, *supra* note 1, at 244.

¹⁰⁶ Compare *State Bar of Arizona v. Arizona Land Title & Trust Co.*, 366 P.2d 1, 14-15 (Ariz. 1961) (prohibiting broker from preparing documents dealing with conveyances), with *Pope County Bar Ass'n, Inc. v. Suggs*, 624 S.W.2d 828, 830-31 (Ark. 1981) (stating that broker may prepare all documents necessary in transaction), and *Florida Bar v. Irizarry*, 268 So.2d 377, 378-79 (1972) (stating that broker's activities are limited to certain documents), and *Conway-Bogue Realty Inv. Co. v. Denver Bar Ass'n*, 312 P.2d 998, 1004-07 (Colo. 1957) (stating same). See generally Shane L. Coudey, Note, *Too Many Hands in the Cookie Jar: The Unauthorized Practice of Law by Real Estate Brokers*, 75 OR. L. REV. 889 (1996) (discussing the various practices of brokers that may constitute the unauthorized practice of law).

¹⁰⁷ See, e.g., *Pope County Bar Ass'n.*, 624 S.W.2d at 829 (stating that broker may use a "fill-in-the-blank" form in simple real estate transactions if previously prepared by a lawyer); *Cardinal v. Merrill Lynch Realty/Burnet, Inc.*, 433 N.W.2d 864, 866 (Minn. 1988) (holding that use of preprinted form in transaction incidental to broker's service, and the separate fee charged for a closing did not constitute the unauthorized practice of law where there was no difficult question of law presented); *Cultum v. Heritage House Realtors, Inc.*, 694 P.2d 630, 632 (Wash. 1985) (holding that use of a fill-in-the-blank form prepared by an attorney is not considered unauthorized practice of law).

¹⁰⁸ See Lowell E. Baier, *The Developing Principles in the Law of Unauthorized Practice re Real Estate Brokers*, 9 ST. LOUIS U. L.J. 127, 127 n.1 (1964) (focusing on the use of attorney-prepared forms by real estate brokers).

¹⁰⁹ See *In re Opinion No. 26 of the Comm. on the Unauthorized Practice of Law*, 645 A.2d 1344, 1351 (N.J. 1995); *Duncan & Hill Realty, Inc. v. Department of State*, 405 N.Y.S.2d 339, 344 (4th Dep't 1978).

¹¹⁰ See *In re Opinion No. 26*, 654 A.2d at 1350.

the scope of legal activities that can be undertaken by a lawyer or non-lawyer, but also the standard of competence required in performing these activities.

Additionally, brokers and other non-lawyers have become increasingly involved in performing routine functions in the preparation and closing of a residential real estate transaction.¹¹¹ As they have become more involved and more skilled in the business of these exchanges, the question has to be raised, "What additional value will be added by hiring a lawyer to participate in the transaction?" In other words, if a lawyer has most of the work done by a paralegal, and exercises little or no professional expertise beyond that obtainable from a non-lawyer, why should the lawyer be involved? To justify the lawyer as a participant in the residential transaction, the attorney must in fact add real value. This means doing more and understanding the transaction better than the non-lawyer. If lawyers do not add value, there is no justification for insulating them from competition by non-lawyers. One of the key areas in which the lawyer can add real value to the client's transaction is in dealing with matters of title assurance. A lawyer can make an important contribution to the exchange by obtaining title insurance with sufficient coverage for risk of loss that cannot be eliminated otherwise.

C. *The Lawyer as Risk Manager*

Lawyers are hired by participants in the real estate market not only to recite and apply legal principles, but also to identify and manage the wide assortment of risks that can and should be anticipated in a particular transaction.¹¹² Lawyers must not only be experts in the law, but also in the many areas of risk that may affect the viability of any given residential transaction.¹¹³ The lawyer's job involves understanding the consequences of the law, the role of legal institutions, and the dynamic context in which legal transactions take place.¹¹⁴

¹¹¹ See MALLOY & SMITH, *supra* note 1, at 34-36; see also Braunstein, *supra* note 91, at 260 (attributing the increased role of the brokers to the diminution of the lawyer's role in residential real estate transactions).

¹¹² See MALLOY & SMITH, *supra* note 1, at 34-36. See generally Moore, *supra* note 96.

¹¹³ See MALLOY & SMITH, *supra* note 1, at 34-36.

¹¹⁴ See *id.*

Where possible, the lawyer should act to eliminate or reduce the risk of an unexpected contingency or potential loss.¹¹⁵ Even when certain risks cannot be eliminated, the lawyer must use the law to minimize potential future risks to the client.¹¹⁶ This may include bringing in professionals like building inspectors or surveyors to prepare opinions on the property, or it may involve arranging for insurance to cover known, or knowable, risks such as potential losses due to fire or earthquakes.¹¹⁷ It also involves making use of contract contingencies, representations and warranties, indemnification agreements, subordinations, and a variety of other legal tools.¹¹⁸ All real estate transactions involve risks, and the primary reason for hiring a lawyer is to engage a professional who is competent in the understanding, identification, and proper management of the risks involved.¹¹⁹

Today the client's expectation is that the attorney will inform him of the risks present, their seriousness, and how they can best be managed.¹²⁰ Thus, to truly meet the complete range of client expectations, the real estate attorney must integrate knowledge of both the law and the market to structure a managed approach to the variety of risks that may arise, and to protect, as much as possible, the client's expectations of the value of investment.¹²¹ In this regard, the attorney must be fully familiar with the legal tools for reducing transactional risk, and must understand how to select the appropriate tools from among several possible approaches.

An attorney's inattention, negligence, or incompetence in handling any aspect of a residential transaction can result in tremendous financial hardship to the client.¹²² This is because a misstep will very often result in the client's loss of all or a significant portion of the value of the transaction.¹²³ The client

¹¹⁵ See MORGAN & ROTUNDA, *supra* note 86, at 77.

¹¹⁶ See *id.*

¹¹⁷ See MITCHELL G. WILLIAMS & HARLAN J. ONSRUD, WHAT EVERY LAWYER SHOULD KNOW ABOUT TITLE SURVEYS, LAND SURVEYS: A GUIDE FOR LAWYERS (1989).

¹¹⁸ See *id.*

¹¹⁹ See MALLOY & SMITH, *supra* note 1, at 34–36. See generally Moore, *supra* note 96.

¹²⁰ See MALLOY & SMITH, *supra* note 1, at 35.

¹²¹ See *id.*

¹²² See MORGAN & ROTUNDA, *supra* note 86, at 77.

¹²³ See MORGAN & ROTUNDA, *supra* note 86, at 78–79 (discussing the consequences of attorney negligence and legal malpractice).

who is so injured is often anxious and will rightly seek to apportion blame for the loss.¹²⁴ As a transactional risk manager, the lawyer is likely to be the first party to whom the client should turn for answers. The client will rightly seek to determine whether or not the lawyer properly undertook to identify, eliminate, and mitigate the potential risks of the transaction.¹²⁵

The client will judge the lawyer by referencing the steps taken to reduce risk by other parties to the transaction.¹²⁶ In particular, a residential home buyer will often see a substantial overlap of interest between the buyer and any lender that may be financing the home purchase. The buyer will think in terms of the lender's need to avoid the unnecessary risk of loss from a poorly constructed home or the failure of title. The buyer will think in terms of the steps taken to protect the lender from such risks. The buyer should also consider the lawyer's judgment with reference to the underwriting standards for the secondary mortgage market and practices of other lawyers engaged in the newly-integrated real estate market. In this context, it is clear that lender underwriting standards require title insurance to protect the lender.¹²⁷ It is also apparent that every lender obtains title insurance at closing, and that lawyers routinely deal with and assist in the provision of title insurance for lenders.¹²⁸ Furthermore, lawyers in commercial real estate transactions routinely obtain title insurance for their developer/owner clients.¹²⁹ In fact, the financial markets, the mortgage providers, and the legal profession would all consider it quite unusual and, indeed, incompetent to do a real estate

¹²⁴ See *id.*

¹²⁵ See MALLOY & SMITH, *supra* note 1, at 35.

¹²⁶ See *id.* at 34-36; see also POWELL, *supra* note 62, § 92.01[1] (discussing the underwriting analysis that an insurance company performs to assess the risk of insuring title for a specific property).

¹²⁷ See generally Joyce Dickey Palomar, *Bank Control of Title Insurance Companies: Perils to the Public that Bank Regulators Have Ignored*, 44 SW. L.J. 905, 927 (1990) ("Today title insurance is the preferred method of protecting purchasers and lenders in the United States against loss from unexpected encumbrances and undiscovered claims . . .").

¹²⁸ See *id.* at 929 (explaining the attorney's role in assisting both the title insurance company and the buyer in the transaction).

¹²⁹ See *id.* See generally *RTC Mortgage Trust v. Fidelity Nat'l Title Ins. Co.*, 58 F. Supp. 2d 503 (D.N.J. 1999) (resolving a dispute among a lender, an insurance company, a commercial developer, and the lawyer who acted as closing agent).

closing for a lender or commercial developer without providing title insurance to cover the risk of loss from title defects.¹³⁰ Given this, it is difficult to defend the idea that perhaps the only person that does not need title insurance is the residential homebuyer when making the single biggest purchase of his or her life. Thus, unless the attorney fully understands the demands of the newly-integrated residential real estate market and properly manages the multitude of risks inherent in that market, the lawyer will not live up to the client's expectations or to the professional standards required for advising a client.¹³¹

III. RISKS OF TITLE EXAMINATION

One of the most important areas of risk to be addressed by an attorney in a real estate transaction involves the confirmation and assurance of title as bargained for in the contract of purchase and sale.¹³² Most frequently, the bargained-for title in the contract involves the granting of a marketable title in a fee simple interest in land.¹³³ Confirming and assuring the quality of this title is not easy.¹³⁴ Under our system of recording, as opposed to a registration system of land titles, public records provide only evidence of (but not proof of) the quality of title.¹³⁵ Consequently, there are a number of risks, both on and off the record, that may adversely affect the status of title.¹³⁶ To

¹³⁰ See POWELL, *supra* note 62, § 92.01 ("Given the increasing complexity of our nation's laws, the vast array of matters that affect title to real estate and our litigious culture, it is difficult to imagine any situation in which counsel would not insist upon [title insurance] for their clients.").

¹³¹ See MALLOY & SMITH, *supra* note 1, at 36; see also *North Bay Council, Inc. v. Bruckner*, 563 A.2d 428, 431 (N.H. 1989) ("[A] lawyer evaluating title to real property for an intending buyer is bound by the standard of professional care . . .").

¹³² See MALLOY & SMITH, *supra* note 1, at 519; see also *Regan v. Lanze*, 354 N.E.2d 818, 822 (N.Y. 1976) ("Marketable title has been defined as one that may be freely made the subject of resale."); *Tesdale v. Hanes*, 82 N.W.2d 119, 124 (Iowa 1957) (resolving a dispute over the validity of marketable title due to defects in the chain of title); *Josefowicz v. Porter* 108 A.2d 865, 866-67 (N.J. Super. Ct. App. Div. 1954) (involving a dispute concerning marketable title and encumbrances).

¹³³ See MALLOY & SMITH, *supra* note 1, at 324-27; see also *Regan*, 354 N.E.2d at 822; *Tesdale*, 82 N.W.2d at 119.

¹³⁴ See MALLOY & SMITH, *supra* note 1, at 326-27. See generally *Tesdale*, 82 N.W.2d at 119 (involving dispute over an attorney's actions in confirming marketable title).

¹³⁵ See Owen L. Anderson & Charles T. Edin, *The Growing Uncertainty of Real Estate Titles*, 65 NOTRE DAME L. REV. 1, 3-5, 44-45 (1989) (discussing the difference between registration systems and recording systems).

¹³⁶ See *id.*

identify and manage these potential risks, the lawyer usually appreciates the need for a survey, a visual inspection of the land, and a careful review of all the available title information.¹³⁷

This section of the paper will explain some of the risks that confront the lawyer with respect to confirming and assuring titles in land. Most importantly, we want to bring attention to examples of risks that cannot be eliminated with even the most diligent and careful of title examinations. The recognition of these risks and the acknowledgement of a national standard for insuring against these risks gives particular credence to our assertion of a duty to obtain fee owner's title insurance in all cases when the client has not expressly rejected such coverage after full disclosure and adequate counsel to the contrary. We proceed by first discussing examples of off-record risks to title, and then on-record risks, including the risks of the recording process itself.

A. *Off-Record Risks*

All jurisdictions in the United States have enacted recording statutes to help resolve competing land claims.¹³⁸ Although these acts vary considerably from state to state, they have the common feature of establishing a recording system that provides for the recording of instruments that affect title to land.¹³⁹ One of the major functions of the recording system is title assurance.¹⁴⁰ Recording systems seek to reduce the risk that the quality or quantity of an owner's estate will differ from the searching party's expectation.¹⁴¹ This goal is accomplished by

¹³⁷ See generally WILLIAMS & ONSRUD, *supra* note 117; see also *Saxby v. S. Land Co.*, 63 S.E. 423 (Va. 1909) (noting the legal ramifications of an incorrect survey); WALTER G. ROBILLARD & LANE J. BOUMAN, CLARK ON SURVEYING AND BOUNDARIES § 2.01, at 23-25 (6th ed. 1992) (discussing the legal role of the surveyor).

¹³⁸ See MALLOY & SMITH, *supra* note 1, at 430; THOMPSON ON REAL PROPERTY § 92.04 (Thomas ed., 1994) [hereinafter THOMPSON] (discussing the American recording system).

¹³⁹ See MALLOY & SMITH, *supra* note 1, at 430; THOMPSON, *supra* note 138, § 92.05.

¹⁴⁰ See MALLOY & SMITH, *supra* note 1, at 430; THOMPSON, *supra* note 138, § 92.04.

¹⁴¹ See MALLOY & SMITH, *supra* note 1, at 430; THOMPSON, *supra* note 138, § 92.04.

providing a relatively simple means for the buyer or some other party to confirm their expectations about the status of title.¹⁴²

Deeds or other instruments which convey an interest in land must be properly recorded with the recording office to give notice to third parties.¹⁴³ In this way, every recording statute modifies, without completely displacing, the common law "first in time, first in right" title rule.¹⁴⁴ In a certain limited set of circumstances defined by each particular recording statute, a subsequent taker of an interest in land may be able to supersede a prior valid interest that was left unrecorded.¹⁴⁵ These acts generally offer substantial protection for a so-called bona-fide purchaser against the holder of an unrecorded interest.¹⁴⁶

Recording acts generally only protect bona-fide purchasers against an off-the-record interest that is capable of being recorded in the first place.¹⁴⁷ Each recording statute defines precisely which instruments can and should be recorded.¹⁴⁸ While the scope of these recording statutes vary between jurisdictions, in every state there are many interests in land that need not be recorded.¹⁴⁹ This is often the case with encumbrances and encroachments that arise by implication rather than by agreement of the parties.¹⁵⁰ The protections offered to a bona-fide purchaser by the recording statutes have no application to these interests. Thus, if a prior-in-time claimant asserts a property right that is not permitted to be placed on the record, the subsequent purchaser will have no

¹⁴² See MALLOY & SMITH, *supra* note 1, at 430; THOMPSON, *supra* note 138, § 92.04.

¹⁴³ See MALLOY & SMITH, *supra* note 1, at 430; THOMPSON, *supra* note 138, § 92.04. Note that interests in land that are not properly recorded are always still valid between the parties themselves. The object of recordation is notice to third parties.

¹⁴⁴ See Lawrence Berger, *An Analysis of the Doctrine that "First in Time is First in Right,"* 64 NEB. L. REV. 349, 354 (1985).

¹⁴⁵ See MALLOY & SMITH, *supra* note 1, at 439.

¹⁴⁶ See *id.* See generally Corwin W. Johnson, *Purpose and Scope of Recording Statutes*, 47 IOWA L. REV. 231 (1962); see also THOMPSON, *supra* note 138, § 92.01 (describing the purpose of the recording statutes); POWELL, *supra* note 62, § 92.04[3] (discussing off-record matters affecting title).

¹⁴⁷ See Johnson, *supra* note 146, at 231 (discussing the objectives of the recording statutes and the protection afforded by the statutes).

¹⁴⁸ See MALLOY & SMITH, *supra* note 1, at 440; see also THOMPSON, *supra* note 138, § 92.06 (exploring the requisites for recordation).

¹⁴⁹ See THOMPSON, *supra* note 138, § 92.06.

¹⁵⁰ See *id.*

means of discovering the interest in the recording system and will have no appeal to provisions of the recording act that protect bona-fide purchasers.

The law of adverse possession is one such example. Adverse possession is designed to strengthen titles by barring potential claims of persons who are not in possession of the land under certain conditions.¹⁵¹ Title by adverse possession is acquired after a non-owner has occupied a particular property in a certain manner for a statutorily defined period of time.¹⁵² Because such interests are not acquired by any documentation, no recordation takes place.¹⁵³

In this way, the law of adverse possession is a significant obstacle to firmly establishing the quality and quantity of the seller's title. Acquisition of title by adverse possession is established independently of the recordation system.¹⁵⁴ At any given time there may be numerous adverse possession claims outstanding against a particular parcel that have not been litigated.¹⁵⁵ For the most part, persons who are able to prove the elements of an adverse possession claim have no incentive to begin the judicial proceedings associated with their claims until the record owner attempts to interfere with their actual possession and use of the property.¹⁵⁶ Further complicating matters, some adverse possessors may have a claim based upon

¹⁵¹ See JESSE DUKEMINIER & JAMES E. KRIER, PROPERTY 120-22 (3d ed. 1993) (examining the law of adverse possession).

¹⁵² See *id.* at 122.

¹⁵³ See MALLOY & SMITH, *supra* note 1, at 331.

¹⁵⁴ See *Connell v. Ellison*, 448 N.Y.S.2d 580, 582 (3d Dep't 1982), *aff'd* 447 N.E.2d 76 (N.Y. 1982) ("Title to property by adverse possession is not affected by the recording act . . ."); DUKEMINIER & KRIER, *supra* note 151, at 122.

¹⁵⁵ See MALLOY & SMITH, *supra* note 1, at 331. In one case, the city of Tonawanda, New York sought to eject as many as 41 adverse possessors, including a homeowner's association, from one strip of creek-front land. See *City of Tonawanda v. Ellicot Creek Homeowner's Ass'n*, 449 N.Y.S.2d 116 (4th Dep't 1982).

¹⁵⁶ See MALLOY & SMITH, *supra* note 1, at 331. An adverse possessor would be well advised not to pursue a claim for two reasons. First, an adverse possession by mistake can nevertheless be hostile. See *West v. Tilley*, 306 N.Y.S.2d 591, 595 (4th Dep't 1970) (concluding that possession by mistake is still adverse). A real owner, however, may still attempt to defeat an adverse possessor's claim for lack of the necessary intent. See *Christopher v. Rosse*, 458 N.Y.S.2d 8, 10 (3d Dep't 1982) (stating that a lack of evidence of "wil[l]ful action" by an adverse possessor precluded an assertion of an "adverse right"). Second, the elements of an adverse possession claim, in a declaratory judgment action to establish title, must be proven by clear and convincing evidence—a relatively high burden of proof. See *Rusoff v. Engel*, 452 N.Y.S.2d 250, 251 (2d Dep't 1982).

“color of title,” and thus not even know that they are adverse possessors yet.¹⁵⁷ The goal of establishing the quality and quantity of seller’s title to the residential property is made appreciably more difficult, if not impossible, by the existence of an adverse possession claim before it is completely litigated.

Another example of an off-the-record interest that poses an obstacle to assuring title is a mistake by the recordation office. Recording generally requires proper delivery to the recording office and payment of the recording fee.¹⁵⁸ As might be expected, however, the recordation office occasionally makes mistakes in handling documents.¹⁵⁹ Sometimes a valid interest that has been properly recorded cannot be found because of a filing error.¹⁶⁰ The risk associated with such errors is usually placed on the later title searcher.¹⁶¹ No amount of diligence will permit a searcher to discover such an interest. Although the searcher is not at fault, the searcher may have a great deal of difficulty in fully recovering the losses sustained therefrom.¹⁶² Off-the-record interests may also include Indian land claims or judicially-constructed or implied interests.¹⁶³

¹⁵⁷ See *Goff v. Shultis*, 257 N.E.2d 882 (N.Y. 1970) (finding possession under an erroneous tax deed sufficient for adverse possession); see also MALLOY & SMITH, *supra* note 1, at 331.

¹⁵⁸ See N.Y. REAL PROP. LAW § 297 (McKinney 1998) (“A conveyance of real property . . . may be recorded . . . upon the request of any party, or tender of the lawful fees therefor.”); see also MALLOY & SMITH, *supra* note 1, at 485.

¹⁵⁹ See N.Y. REAL PROP. LAW § 297 (McKinney 1998). A recording officer guilty of “misfeasance or fraudulent practice” in the recording of an instrument may be held liable in damages to the person injured. See *id.*; see also MALLOY & SMITH, *supra* note 1, at 485.

¹⁶⁰ See MALLOY & SMITH, *supra* note 1, at 485. In one case, a purchaser was held not to be on notice of a deed which, although properly recorded, was not indexed. See *Camfield v. Luther Forest Corp.*, 414 N.Y.S.2d 833, 835 (Sup. Ct. Saratoga County 1979).

¹⁶¹ See *Puglisi v. Belaski*, 193 N.Y.S. 357, 358–59 (Sup. Ct. Kings County 1922) (“The record of an instrument . . . recorded not as it should be . . . is not constructive notice.”); see also MALLOY & SMITH, *supra* note 1, at 486–87.

¹⁶² See *Hood v. Webster*, 2 N.E.2d 43, 44 (N.Y. 1936) (holding that for a subsequent purchaser to prevail against a prior unrecorded owner, purchaser must prove good faith purchaser status by “a fair preponderance of the evidence”); see also MALLOY & SMITH, *supra* note 1, at 485.

¹⁶³ See MALLOY & SMITH, *supra* note 1, at 487; see also N.Y. INDIAN LAW § 7-a (McKinney Supp. 1999–2000) (“No purchase . . . of lands of Indians in this state, shall be valid unless made under the authority, and with the consent of the legislature.”); *Fila v. Angiolillo*, 451 N.Y.S.2d 316, 318 (3d Dep’t 1982) (finding a pathway on private land subject to an easement by prescription).

B. *On-Record Risks*

Even where all interests in a particular parcel of land seem to have been recorded and properly filed, the recording system is by no means foolproof.¹⁶⁴ There are problems with forged documents and fraudulent conveyances that may make a record title inconsistent internally or incongruous with the actual title to a given piece of land.¹⁶⁵ Even the most diligent lawyer will be unable to uncover and eliminate these types of risks. There are also less obvious risks such as those associated with wild deeds and early or late recorded documents.

A major pitfall in most recording systems involves the so-called wild deed. A wild deed is an instrument of conveyance that is literally recorded, but cannot be found by using the recordation index.¹⁶⁶ Because it cannot be found, the wild deed poses a significant problem for searchers.

Presume a situation in which Jon, the original owner of a parcel, is a double-dealer and attempts to convey his land twice—first to Linda, and later to Mike. Also suppose the transfer from Jon to Linda is valid in every way except that the parties fail to properly record it. Prior to the double-deal which transfers the property from Jon to Mike, Linda conveys the property to Susan. Susan promptly records her interest. Then, chronologically, the second transfer takes place from Jon to Mike. At this point Susan is the proper owner of the land because despite Linda's failure to properly record the original transfer, Susan's interest is recorded prior to Mike's.

Now Buyer contracts with Mike to acquire the property. In order to ensure that Mike is the rightful owner, Buyer undertakes a title search. Buyer, however, cannot possibly discover that Susan is the true owner of the property. Buyer will

¹⁶⁴ See Taylor Mattis, *Recording Acts: Anachronistic Reliance*, 25 REAL PROP. PROB. & TR. J. 17, 94-95 (1990) (comparing the efficacy of different types of recording acts).

¹⁶⁵ See *Marden v. Dorothy*, 54 N.E. 726, 731 (N.Y. 1899) (noting that recording acts are not applicable to forged documents); see also *Larsen v. Potter*, 571 N.Y.S.2d 121, 123 (3d Dep't 1991) (stating that mistakes in description, quality, or condition of land conveyed may, under the circumstances, be grounds for setting aside the deed).

¹⁶⁶ See MALLOY & SMITH, *supra* note 1, at 478; see also *Barber v. Rowe*, 193 N.Y.S. 157, 162 (3d Dep't 1922), *aff'd*, 139 N.E. 730 (N.Y. 1922) (stating that a purchaser of real property is charged with constructive notice of the contents of the deeds referenced).

construct a chain of title and discover that Mike properly acquired the property from Jon, the original owner. A diligent Buyer will check to see if either Mike or Jon attempted to convey the property more than once. Buyer cannot hope to find the conveyance from Jon to Linda because it was not recorded. Thus, there will be nothing in the index to link Linda's conveyance to Susan, which was recorded, with the transfer of this property. Buyer will have every reason to believe that Mike has good title.

The early recorded deed and the late recorded deed pose a similar problem to the wild deed in that the recording system impairs the searcher's ability to find them. An instrument of conveyance is late recorded when a substantial time gap exists between delivery and recordation.¹⁶⁷ This time gap makes it difficult for a searcher to discover the adverse interest.

Suppose Jon, again the original owner of a parcel, grants an easement across his land to Linda in 1994. Linda does not record the interest until 1998. In the interim, Jon sells the parcel outright to Mike. Now, in 2000, Buyer contracts to buy the property from Mike. In order to ensure that Mike is the rightful owner of the estate, Buyer undertakes a title search. Buyer will see that the transfer from the original owner, Jon, to Mike has been properly recorded. A diligent buyer will check to see if either Mike or Jon attempted to create any adverse interests on the property. The difficulty, however, is that Buyer will look in the indexes for adverse transfers created by Jon only in the time period of his ownership. Thus, Buyer will not find Linda's easement because it was recorded after Jon sold the property to Mike.

The early recorded deed problem is, essentially, the flip side of the late recorded deed problem. An instrument of conveyance is early recorded when a person transfers an interest in land before actual delivery.¹⁶⁸ Using the previous hypothetical, suppose that, in anticipation of acquiring Jon's land, Mike grants an easement against that land to Susan. Susan records her

¹⁶⁷ See MALLOY & SMITH, *supra* note 1, at 479; see also *Hochschwender v. Dorlo Corp.*, 211 N.Y.S.2d 948, 951 (Sup. Ct. Nassau County 1960) ("Recording of a deed raises a presumption of delivery, but the presumption is effective only as of the date of recording, not the date of execution."). This presumption, however, must yield to opposing evidence. See *Winick v. Winick*, 272 N.Y.S.2d 869, 871 (2d Dep't 1966).

¹⁶⁸ See MALLOY & SMITH, *supra* note 1, at 479.

interest promptly. Soon thereafter, Mike records his purchase of the property from Jon. Now Buyer enters into a contract to acquire Mike's land. Buyer's title search, however, will not reveal Susan's interest because the searcher will not look for adverse interests created by Mike prior to his ownership of the property. Again, serious consequences will result.

IV. METHODS OF TITLE ASSURANCE

Uncertainty as to the validity of title constitutes a historical risk.¹⁶⁹ The risk of title error is historical in the sense that reaching a judgment about title involves the evaluation of evidence about the past.¹⁷⁰ As a consequence of flaws in our system of land titles, there is always a risk that what appears to be a valid title is, in fact, not.¹⁷¹ These defects allow a searcher, at best, to obtain only probable answers.¹⁷² No matter how hard the parties try, they can never entirely eliminate this historical risk.¹⁷³ Thus, as a system for title assurance, the protections afforded by recording systems are by no means foolproof.¹⁷⁴ Accordingly, it becomes the objective of any party with an interest in the property to reduce the total risk of uncertainty, and properly manage the title risk which that party must bear.

Having explored the nature of risk in title examination, we now turn our attention to methods of managing title risks. Because the parties to a residential real estate transaction will rarely undertake a full investigation of the status of title to the property prior to contracting, managing title risks is typically handled during the executory contract period.¹⁷⁵ There are two primary aspects in the process of assuring title. The first is the

¹⁶⁹ See *id.*

¹⁷⁰ See *John T. Clark Realty Co. v. Harris*, 2 N.Y.S. 137, 142 (2d Dep't 1938) (stating that if a deed is void, neither present nor subsequent grantees can acquire good title); see also MALLOY & SMITH, *supra* note 1, at 323.

¹⁷¹ See MALLOY & SMITH, *supra* note 1, at 430; see also *supra* notes 154-55, 157, 160-61, 163-68, 170.

¹⁷² See MALLOY & SMITH, *supra* note 1, at 324.

¹⁷³ See *id.* at 430.

¹⁷⁴ See *id.*

¹⁷⁵ See *id.* at 324; 2 DAVID C.B. HARVEY, HARVEY'S LAW OF REAL PROPERTY AND TITLE CLOSING § 495 (1984) ("The primary purpose of fixing a closing date in a contract of sale is to allow a purchaser to search the title to ascertain (1) whether he has contracted to buy a marketable title, and (2) what restrictions there may be, such as easements, restrictive covenants, zoning, etc.").

title search.¹⁷⁶ This procedure consists of searching the recordation system for adverse interests in order to ensure that the searcher's expectations for the property are met.¹⁷⁷ The second aspect of assuring title is the final product of this search.¹⁷⁸ The initial search process can result in several different types of final products, each giving a different set of rights to the purchaser.¹⁷⁹ This section discusses the three primary title assurance products that are available on the market. We discuss the costs and benefits of these divergent methods and comment on the standard of liability that applies to errors or omissions with respect to each approach. We also comment on the way in which each method of title assurance addresses the lawyer's ability to effectively manage title risk for the client. We focus on the need to evaluate each approach in terms of its ability to establish reasonably certain expectations about the status of a particular title and its ability to provide adequate protection against loss. The three methods of title assurance that we cover are the title abstract; the lawyer's title opinion; and title insurance.

A. *Title Abstracts*

A title abstract is a distillation of information gathered from specifically-identified sources such as the public records and the real property tax rolls that purport to reflect all of the relevant

¹⁷⁶ See MALLOY & SMITH, *supra* note 1, at 323; see also *Vanderveer v. Callanan Indus., Inc.*, 470 N.Y.S.2d 756, 757 (3d Dep't 1983) (stating that a title search "refers to the record chain of title and any easements, covenants, liens or the like which would be disclosed therein").

¹⁷⁷ See MALLOY & SMITH, *supra* note 1, at 323; see also *Andy Assoc., Inc. v. Banker's Trust Co.*, 399 N.E.2d 1160, 1164 (N.Y. 1979) ("[A] purchaser of an interest in land . . . has no cause for complaint . . . when its interest is upset as a result of a prior claim against the land . . . which was apparent on the face of the public record . . .").

¹⁷⁸ See MALLOY & SMITH, *supra* note 1, at 323. It is customary in real estate practice for the purchaser to conduct a title search and to forward a report of that search to the seller's attorney in the event of any objections to seller's title. See IRVING I. STEINMAN ET AL., *NEW YORK REAL PROPERTY FORMS, FORM 1* (1999).

¹⁷⁹ See MALLOY & SMITH, *supra* note 1, at 497. Different defects in title may result in different obligations on the purchaser to accept title. Compare *Andrew v. Roth*, 433 N.Y.S.2d 274, 275 (3d Dep't 1979) (finding a boundary dispute "minor" and requiring purchaser to accept title) with *Regan v. Lanze*, 354 N.E.2d 818, 822-23 (N.Y. 1976) (finding a defect that could only be defeated by resort to parol evidence to render title unmarketable and allowing purchaser to refuse title).

interests that affect a given piece of property.¹⁸⁰ If the abstract is "complete," it will take the chain of title all the way back to the sovereign.¹⁸¹ But today it is customary for the abstracts to go back only fifty or sixty years.¹⁸² Typically, the abstractor will study a predetermined list of recorded documents and catalogue the pertinent information on a standardized form.¹⁸³ Most abstracts are arranged chronologically, with a summary of all information found during the specified period.¹⁸⁴

It is important to understand that the purpose of the abstract is to give the purchaser sufficient information to decide whether record title is acceptable.¹⁸⁵ The abstract, by itself, offers no conclusions about the present state of title.¹⁸⁶ Instead, interpretation of the abstracted documents is left solely for the reader.¹⁸⁷ Because of the complexity of the information presented, the untrained eye is typically unable to decipher the meaning of all the gathered information. Thus, in the context of a residential transaction, a title abstract is virtually of no use to

¹⁸⁰ See MALLOY & SMITH, *supra* note 1, at 497; see also 1 AM. JUR. 2D *Abstracts of Title* § 1 (1994).

¹⁸¹ See MALLOY & SMITH, *supra* note 1, at 497-98; see also 14 WARREN'S WEED NEW YORK REAL PROPERTY, TITLE EXAMINATION § 1.09 (4th ed. 1998) [hereinafter WARREN'S WEED].

¹⁸² See MALLOY & SMITH, *supra* note 1, at 498. In some areas, title searchers will only reach back 40 years when the property has been improved and occupied by the seller. See WARREN'S WEED, *supra* note 181, § 1.09.

¹⁸³ See MALLOY & SMITH, *supra* note 1, at 498; see also *Glawatz v. People's Guar. Search Co.*, 63 N.Y.S. 691, 692 (4th Dep't 1900) (stating that an abstractor's duty is to "set forth an accurate and complete statement of any and all matters in anywise affecting or relating to the title of the premises against which the search was made").

¹⁸⁴ See MALLOY & SMITH, *supra* note 1, at 498; see also WARREN'S WEED, *supra* note 181, § 3.02 ("A complete chain of title report should trace the history of the ownership of the title to property beginning with the origin of title and include each transfer down to the present owner.").

¹⁸⁵ See MALLOY & SMITH, *supra* note 1, at 498; see also D. BARLOW BURKE, JR., LAW OF TITLE INSURANCE § 15.1 (1986) (describing the title search procedure and reasons for conducting a title search); 1 CLINTON P. FLICK, ABSTRACT AND TITLE PRACTICE 116-18 (2d ed. 1958) (describing the contents of the abstract and making suggestions for compiling an abstract).

¹⁸⁶ See MALLOY & SMITH, *supra* note 1, at 498; see 1 LOGAN D. FITCH, ABSTRACTS AND TITLE TO REAL PROPERTY 1-5 (1954) (defining an abstract, its essential components, and the American method of compiling abstracts).

¹⁸⁷ See MALLOY & SMITH, *supra* note 1, at 498; see also L. SIMES, A HANDBOOK FOR MORE EFFICIENT CONVEYANCING 3-4 (1961), reprinted in PAUL GOLDSTEIN, REAL ESTATE TRANSACTIONS: CASES AND MATERIALS ON LAND TRANSFER, DEVELOPMENT AND FINANCE 245 (1980) (describing the need for a lawyer to examine the abstract in the lawyer-abstract system).

a typical home buyer without some supplemental evaluation by a professional—often by an attorney opinion letter.

Title abstracts provide a fault-based system of title assurance. This means that abstractor liability for errors or omissions turns on the ability of a plaintiff to prove that the abstractor failed to use the requisite care in preparing the abstract.¹⁸⁸ Assuming that the requisite level of care would not have revealed the error or omission that caused the loss, the abstractor will not be liable.¹⁸⁹ In addition, because the abstract does not purport to opine on the status of title, the abstractor is only liable for failing to meet the appropriate standard of care in collecting and reporting information.¹⁹⁰ To be of use in a residential real estate transaction, however, the abstract must be interpreted by a competent professional.¹⁹¹ This can be the abstractor or another person, such as an attorney.¹⁹² Because this person needs to provide a clear statement interpreting the abstract in a form that the purchaser can understand, it will, in the end, be this professional who bears the majority of the liability should something go awry. Consequently, liability for loss may be apportioned based on the reason for the loss, an error or omission in collecting and reporting relevant title information, or a substandard interpretation of the abstracted materials. In any event, the abstract involves a fault-based approach to title assurance. This means that the homebuyer will suffer the loss of a known type of risk as long as the abstractor used reasonable care in preparing the abstract.

¹⁸⁸ See, e.g., *First Am. Title Ins. Co. v. First Title Serv. Co.*, 457 So. 2d 467, 469 (Fla. 1984) (finding an abstractor liable in negligence to a known third-party user of an abstract); see also *Sickler v. Indian River Abstract & Guar. Co.*, 195 So. 195, 197 (Fla. 1940) (“An abstractor is liable in damages for injuries resulting from wrongful or negligent errors, defects, or omissions in an abstract prepared and furnished by him.”); FITCH, *supra* note 186, at 7–13 (discussing abstractor’s liability for errors).

¹⁸⁹ See *First Am. Title Ins. Co.*, 457 So. 2d at 473–74.

¹⁹⁰ See *id.*; see also GOLDSTEIN, *supra* note 187, at 252–53 (discussing abstractor’s defenses to negligence actions); JAMES L. GOSDIN, *TITLE INSURANCE: A COMPREHENSIVE OVERVIEW* 92–101 (1996) (listing every state’s standards for abstractor negligence).

¹⁹¹ See MALLOY & SMITH, *supra* note 1, at 498; see also Comment, *Title Insurance: The Duty to Search*, 71 *YALE L.J.* 1161, 1163 (1962).

¹⁹² See MALLOY & SMITH, *supra* note 1, at 498.

B. Attorney Title Opinions

An attorney opinion letter, sometimes called a title certificate, is simply a document that purports to protect the client's expectations concerning the status of title.¹⁹³ In producing an opinion letter, the attorney will gather the relevant information (often from a title abstract), review that information, and give a legal opinion as to whether the current status of title meets the particular standard demanded by the contract and the client.¹⁹⁴

A title opinion or certificate, however, does not guarantee that title is in fact marketable.¹⁹⁵ It only reflects the attorney's professional opinion that title appears to be marketable or as otherwise contracted.¹⁹⁶ All the title attorney promises is that the attorney has done competent, professional work, complying with the opinion-writing norms established by and followed in the relevant legal community.¹⁹⁷

Title opinions, thus, also provide a fault-based system of title assurance. Since the attorney is not an absolute insurer, the attorney is only liable for failing to meet the appropriate standard of care in preparing and integrating the information.¹⁹⁸ In this approach to title assurance, the opinion is only as good as the expertise of the lawyer and then only as valuable as that

¹⁹³ See MALLOY & SMITH, *supra* note 1, at 506; see also Comment, *supra* note 191, at 1163.

¹⁹⁴ See MALLOY & SMITH, *supra* note 1, at 506; see also Dale A. Whitman, *Optimizing Land Title Assurance Systems*, 42 GEO. WASH. L. REV. 40, 47-48 (1973) (discussing five methods of generating an opinion letter and where each of the methods is geographically prevalent).

¹⁹⁵ See MALLOY & SMITH, *supra* note 1, at 506; see also Comment, *supra* note 191, at 1163-64.

¹⁹⁶ See MALLOY & SMITH, *supra* note 1, at 506. The attorney is not responsible for information that is unavailable or inaccurate as a result of mistake, misspelling or misfiling. Courts have consistently not held abstractors or attorneys to such a strict liability standard. See, e.g., *Savings Bank v. Ward*, 100 U.S. 195, 198 (1879); *Adams v. Greer*, 114 F. Supp. 770, 775 (W.D. Ark. 1953).

¹⁹⁷ See MALLOY & SMITH, *supra* note 1, at 506; see also John W. Wade, *The Attorney's Liability for Negligence*, 12 VAND. L. REV. 755, 762-63 (1959) (discussing the standard of care an attorney must exercise).

¹⁹⁸ See, e.g., *North Bay Council, Inc. v. Bruckner*, 563 A.2d 428, 431 (N.H. 1989) (holding that an attorney is subject to a prudent purchaser standard and must disclose defects that would reasonably lead to refusal of the conveyance by such a prudent purchaser). See generally Joseph T. Bockrath, Annotation, *Liability of Attorney for Negligence in Connection with Investigation or Certification of Title to Real Estate*, 59 A.L.R. 3d 1176 (1974) (stating that attorney liability is predicated on specific acts or omissions).

lawyer's malpractice insurance. The client will not be covered for risks that could not have been discovered or eliminated by adhering to appropriate search and examination standards.¹⁹⁹ Thus, the client will not be covered for losses due to forged or fraudulent documents, misfilings, mistakes made by the recording office, wild deeds, or other undetectable but known risks.²⁰⁰ These risks can go undetected even when a lawyer uses the highest standards of care and diligence.²⁰¹ Consequently, every lawyer knows that a homebuyer, like a lender, faces certain risks of loss that will not be eliminated by the preparation of a proper title opinion. Furthermore, the lawyer knows that there will be no liability for failure to detect these types of risks.

C. Title Insurance

Title insurance, as a method of title assurance, has two primary functions. First, the title insurer searches the records and discloses its findings to ensure that the current status of title meets the dictates of the contract and the purchaser's needs.²⁰² Similar to title abstracts and attorney opinion letters, here the purchaser is paying to acquire valuable information in order to reduce the historical risks associated with residential real estate transactions.²⁰³

The second function of title insurance is to insure against undisclosed or undiscoverable risks.²⁰⁴ Title insurance, therefore, insures against losses resulting from forged or fraudulent documents as well as the other known but undetectable risks.²⁰⁵ This method of risk spreading is the

¹⁹⁹ See *North Bay Council*, 563 A.2d at 431.

²⁰⁰ See *supra* note 196 and accompanying text.

²⁰¹ See MALLOY & SMITH, *supra* note 1, at 508.

²⁰² See *id.* at 518; see also BURKE, *supra* note 185, § 1.5 (describing the differences between marketable and insurable title in the context of a client's needs); LEFCOE, *supra* note 64, at 245 (noting that the buyer wants proof of all title risks they are assuming).

²⁰³ See MALLOY & SMITH, *supra* note 1, at 518; see also BURKE, *supra* note 185, § 1.1 (discussing the "exclusively American invention" of title insurance).

²⁰⁴ See Joyce Dickey Palomar, *Title Insurance Companies' Liability for Failure to Search Title and Disclose Record Title*, 20 CREIGHTON L. REV. 455, 456 (1987).

²⁰⁵ See *id.*; see also Quintin Johnstone, *Title Insurance*, 66 YALE L.J. 492, 495-96 (1957) (listing the types of risk usually covered by title companies); Note, *The Title Insurance Industry and Governmental Regulation*, 53 VA. L. REV. 1523, 1524-25 (1967).

classic function of all types of insurance products.²⁰⁶ In this way title insurance provides a strict liability form of title assurance.²⁰⁷ If there is a loss covered by the policy, the purchaser is entitled to recoup without having to show that the title company was at fault or failed to meet certain professional standards.²⁰⁸ This is the critical difference between title abstracts or attorney opinion letters, and title insurance. The insured will recover for loss, regardless of fault, so long as the loss is one which is covered by the purchaser's policy.²⁰⁹ It is for this reason that, in modern transactions, national underwriting standards require lenders to obtain title insurance and it is the reason that buyers should also be advised to obtain fee owner's insurance.²¹⁰ We know that some risks to title exist but cannot be discovered even when using the highest standards of care and diligence.²¹¹ There is no protection for a home buyer or lender when they suffer a loss as a result of one of these impossible to discover defects unless they are properly insured by title insurance.

V. THE LAWYER'S DUTY—FURTHER CLARIFICATION

When we considered the standard of liability for each of the three methods of title assurance, we saw that the abstract of title and the attorney opinion letter involved fault-based recovery systems, whereas title insurance involved a strict liability standard for risks covered by the terms of the policy. This means that some risks are known to be undiscoverable even with the most diligent of title searchers, yet they will not be covered under either the abstract or title certificate approaches. Lawyers understand that this risk exists, and that the client will suffer a loss under a fault-based system of title assurance. They also know that there is a third alternative, title insurance, which can readily cover these risks and fully protect the client. Most importantly, homebuyers have no real knowledge or understanding of these issues.

²⁰⁶ See MALLOY & SMITH, *supra* note 1, at 518.

²⁰⁷ See *id.*

²⁰⁸ See *id.* See generally Theodore C. Taub, *Rights and Remedies Under a Title Policy*, 15 REAL PROP. PROB. & TR. J. 422 (1980) (discussing procedures and considerations of an attorney when a defect is found after the transaction).

²⁰⁹ See MALLOY & SMITH, *supra* note 1, at 519.

²¹⁰ See *id.*

²¹¹ See *id.*

Therefore, we now turn our attention to a broader question in which we frame the issue in terms of the standard of professional care to be exercised in selecting the appropriate method of title assurance from the three available approaches. It is on this point that we find reference to local custom and practice for not requiring fee owner's title insurance to be a misguided and erroneous standard. Today, the appropriate standard of practice is with reference to super-regional and national standards. It is clear that this standard supports a duty to obtain a fee owner's policy of title insurance.

In this section of the paper we clarify the basis for finding a duty to obtain fee owner's title insurance for a client in the absence of the client's express rejection of title insurance after full disclosure and explicit advice to the contrary. We do this by linking together several elements already discussed in earlier parts of the article. First, we refocus attention on the transformation of real estate markets away from local to highly integrated super-regional, national, and international markets. We argue that simultaneous with this transformation, in the underlying nature of the real estate market, is a shift to a non-local standard for measuring the professional judgment of attorneys in making decisions about the appropriate method of title assurance. Second, we explain the standards and expectations of the relevant, non-local legal community in terms of the type of title assurance required to protect participants in a real estate transaction from loss due to a failure of title. Finally, we suggest that the attorney's duty to obtain fee owner's title insurance for a client may extend to third party non-clients under certain circumstances.

A. *Refocus on Transforming to a National Market and National Standards*

The provincial residential real estate practice that was the nationwide norm until the late 1970s has crumbled and is now gone. The emergence of the secondary mortgage market, coupled with the many regulatory reforms and market integrations of the past two decades, has radically and irretrievably altered the way in which the residential real estate market operates and, more importantly, the manner in which the business is practiced.

The countless individual local markets for real estate transactions that were dominant in years past have given way to

more fully-integrated markets operating at the super-regional, national, and international levels. This transformation away from the local and toward the national has enhanced the liquidity and profitability of real estate related activities, and has raised important implications for the practice of law. In particular, with respect to the standard applied to the quality of professional legal services, this transformation has shifted the frame of reference for determining a minimal level of competence for professional standards from a traditional community custom to a higher national standard of quality. Nationalization and integration of real estate markets have forged the development of more uniform standards for judging competence in the same way that securities laws and the Uniform Commercial Code have raised the standards in those fields. While peculiar local law may persist in some sectors of state property law, the standards for how to protect against title risks that are known to exist, but which are undetectable, are simple and uniform—in a recording system like that in use in the United States, one needs to obtain title insurance.

B. The Requirements of National Standards

Against this backdrop, uniformity in quality standards has emerged across the nation. There is virtually complete agreement among major players in the modern real estate market that the benefits associated with obtaining title insurance—no-fault protection from loss—far outweigh the relative costs of the product. In the commercial real estate market, for instance, title insurance has been de-facto mandatory for some time, while its acceptance as an industry standard in residential real estate transactions is a more recent occurrence.

In addition to requiring title insurance for commercial real estate activities, modern institutional lenders insist on title insurance as an unconditional prerequisite to financing a residential real estate transaction. Lenders simply do not proceed without it. Similarly, participants in the secondary mortgage market demand that residential mortgages be backed by title insurance as a prerequisite to selling or packaging the loans for the secondary market. By requiring its use, the attorneys for these entities acknowledge that title insurance is the standard for title assurance. They understand the need for

insurance in covering the risk of known but undiscoverable title defects. Attorneys for homebuyers in a variety of markets, particularly in major metropolitan markets, also understand the need for title insurance as the only means of properly assuring title for an owner as well as a lender. For these reasons, title insurance has become the standard in the modern, integrated residential real estate market.

C. The Lawyer's Duty

The duty of attorneys in all their activities on behalf of their clients is to adhere to the accepted standards of the profession. These standards, however, are not stagnant. The real estate market is a dynamic environment. The participants in this market are constantly seeking to improve—to raise the bar. Whether by offering new products to their customers or lowering costs by improving efficiency, the dynamic of the real estate market is constantly driving change in the way business is done. As the industry standards for quality change, so do the professional standards for real estate-related legal services. Finally, when a critical mass of members of the legal community embraces a new procedure or technique, it becomes the new standard for quality. With the emergence of the national real estate market, lawyers cannot immunize themselves from these higher quality standards by referencing the local customs of yesteryear. Where the local custom is below the national standard, continuing to follow the local custom is malpractice.

Adhering to professional standards means that the lawyer, as the risk manager in a residential real estate transaction, must be aware of title risks, discoverable and undiscoverable, and advise the client on how best to limit those risks. Limiting title risks requires the attorney to know the difference in types of title assurance products and the differences in liability standards that attach to each of these products. The professional standards in the modern, highly integrated residential real estate market, however, are more expansive than these responsibilities. Today, it is widely accepted that title insurance is the only appropriate product to fully protect a homeowner or lender from risk of loss. For this reason the industry standard reflects a duty to obtain fee owner's title insurance for a client as a routine matter in all residential transactions. Ignoring this standard is grounds for a

malpractice action. Attorneys can no longer protect themselves in a malpractice action by arguing that the local, antiquated, customs—appropriate in bygone decades—control in the modern residential real estate market.

Of equal importance is a further implication of this standard. An attorney must be fully versed in the coverage of a given title insurance policy, i.e., know in detail its coverage and its exclusions, exceptions, and stipulations. In addition, the attorney must know how to have standard exceptions eliminated and how to provide affirmative coverage against particular risks. Attorneys that are not fully versed in the details of a real estate practice, including the specifics of title insurance, should not represent clients in real estate transactions.

At the same time that the attorney requires title insurance for the buyer, the attorney must also remember that title insurance does not eliminate the need to obtain the highest quality warranty deed as the instrument of conveyance. Title insurance is not a substitute for a warranty deed because some potential risks may be excluded, excepted, or otherwise uncovered by the terms of a particular policy of title insurance. The homebuyer has a need to be able to sue on the warranties in the deed in such a situation. Relying, therefore, on title insurance and failing to obtain a full and proper warranty deed for the homebuyer (as is the practice in some parts of downstate New York) is also grounds for *attorney malpractice*. Thus, the competent lawyer seeks to obtain both a good and proper warranty deed and a fee owner's title insurance policy.

D. Possible Duty to Non-Clients

It is now becoming clear that, in the context of a residential real estate transaction, attorneys may owe a duty of care to non-clients under a certain limited set of circumstances.²¹² The elements required, for purposes of liability, to establish a duty of care to a non-client are that the attorney knows, or should know, that: (1) the non-client will rely upon a legal representation, (2)

²¹² See, e.g., *Hacker v. Holland*, 570 N.E.2d 951, 955 (Ind. Ct. App. 1991); *Grenz v. Prezeau*, 798 P.2d 112, 116 (Mont. 1990); *Fox v. Pollack*, 226 Cal. Rptr. 532, 534 n.2 (Cal. Ct. App. 1986); *Page v. Frazier*, 445 N.E.2d 148, 152 (Mass. 1983); *Zych v. Jones*, 406 N.E.2d 70, 74 (Ill. 1980); *Togstad v. Vesely, Otto, Miller & Keefe*, 291 N.W.2d 686, 693 (Minn. 1980); *Young v. Hecht*, 597 P.2d 682, 686-87 (Kan. Ct. App. 1979); *Kurtenbach v. TeKippe*, 260 N.W.2d 53, 56 (Iowa 1977).

the non-client so relies, and (3) the non-client is not too remote from the lawyer to be entitled to protection.²¹³ In a residential transaction, the situation in which this duty is most likely to arise is when an attorney is representing either the seller or lender and is confronted with an un-represented buyer.²¹⁴ In order for an attorney to avoid liability to a non-client, the attorney should make clear to the buyer, preferably in writing, that the attorney does not represent the non-client and that the non-client should seek independent legal advice.²¹⁵ With respect to title assurance matters, the attorney should further inform the non-client buyer that fee owner's title insurance, although advisable, has not been arranged for the buyer. Finally, the attorney should inform the non-client that while the lender will obtain title insurance to be paid for by the buyer/borrower, the buyer will not be covered under this policy.

VI. FORM FOR NOTICE AND DECLINE OF TITLE INSURANCE

Since we believe an attorney has a duty to obtain fee owner's title insurance for a residential homebuyer, we suggest that a lawyer refuse to represent a buyer that denies coverage. Since this may not always be practicable, however, we recommend that a client who refuses coverage sign a written disclosure document. In our opinion, this form should provide notice and disclosure to the client about the general nature and scope of title risk present in a real estate transaction. The notice should also explain that some risks cannot be eliminated even when the title examiner exercises the highest standards of care. The notice should further state that, in the attorney's professional judgment, the client should obtain fee owner's insurance and that the client's decision to decline coverage is exercised with the knowledge that it goes against the advice of counsel. We suggest a slight variation in this form for use in situations where an attorney may be involved in a residential transaction as counsel to a lender or seller. Here the concern is to give notice of non-representation to the non-client buyer and to disclose the desirability of obtaining a fee owner's title insurance policy.

²¹³ See *Hacker*, 570 N.E.2d at 955.

²¹⁴ See *id.*

²¹⁵ See *id.* at 956.

We do not think that a one or two line statement signed by a client refusing coverage is adequate to relieve an attorney from a claim of malpractice. We also remind the lawyer that if you will share in a title insurance fee, you have a further ethical duty to disclose this fact to the client, to obtain their consent, and to be certain that no conflict of interest is operating to impair your ability to fully represent the best interests of the client.

In this section of the article we provide sample form language that might be incorporated into current disclosures being used by an attorney or that might be drafted as specific disclosures for this particular purpose. We do not include language relevant to the disclosure of a potential conflict of interest resulting from the lawyer sharing in a part of the title insurance fee. This would be relevant to a disclosure form only when the client elects to purchase the fee owner's title insurance policy.

A. *For the Client*

Below is an example of a disclosure statement for the client as it might be drafted:

Dear Client:

This notice of disclosure confirms the following:

(1) You have been informed that title to real property in the United States is governed by a system that provides evidence of ownership but not proof of ownership.

(2) Certain risks that may affect an owner's title cannot be detected even after diligent search and evaluation. Such risks include, without limitation, the possibility that evidence of title may be based on forged or fraudulent documents; that errors may have occurred in the recording process at the recording office; and that certain on and off the record interests may be difficult or impossible to determine.

(3) All methods of title assurance seek to reduce the risk of loss to an owner from a variety of title defects, but only title insurance provides absolute coverage for covered risks. In the absence of title insurance, you will have to prove that the title examiner or abstractor performed their tasks in a way that failed to meet proper standards of care and conduct. This means that you must prove fault. A fault-

based liability system means that the person will not be liable for title problems arising from extremely difficult or impossible to eliminate risks such as those associated with forged or fraudulent documents or certain other on- and off-the-record problems.

(4) Title insurance protects you from extremely difficult or impossible to eliminate risks to the extent such risks are covered by the policy.

(5) If a lender is involved in this transaction, you should know that the lender requires and will obtain title insurance. You will not be covered by the lender's insurance and will only be covered if you pay for and acquire your own policy of fee title insurance.

(6) To the extent that a lender (if one is involved in this transaction) may sell your mortgage in the secondary mortgage market, underwriting requirements will require that title insurance be obtained for the lender.

(7) After full disclosure, you have declined fee owner's title insurance protection and seek to proceed without such insurance despite my direct legal advice to the contrary.

The client should sign and date the notice form and the attorney should keep a copy in the client's file.

B. For the Non-Client

Below is an example of language which might be used in a disclosure statement to the non-client. The basic elements of the above notice of disclosure to the client should be used, but modified as follows:

Dear Non-Client:

This notice of disclosure confirms the following:

(1) I do not represent you in this transaction. I represent the seller/lender and even though a portion of your closing costs may go toward payment of part or all of my fee, I am not your lawyer.

(2) Because I represent another party in this transaction, I have a duty of loyalty and confidentiality to that other party. I am obligated to look out for and advance their best interests.

(3) You should have your own lawyer to advise you and protect your interests in this transaction.

(4) One matter on which you should seek legal advice from your own attorney involves the availability and advisability of obtaining fee owner's title insurance. Title insurance protects you from risk of loss to your ownership interests.

[Note: The elements of the notice for the client starting with paragraph (2) on that form and continuing through paragraph (6) would be inserted here.]

The letter would close with a statement such as this:

You acknowledge that I do not represent you in this matter and that you have not relied upon me for any legal advice. You also acknowledge that I have advised you of the need for legal counsel and have disclosed to you that one area in which this may be necessary concerns title assurance.

The non-client should sign and date the notice form and the attorney should keep a copy in the appropriate file.

CONCLUSION

The nature of a residential real estate practice has changed dramatically over the past twenty years. Real estate and related financial markets are no longer local but rather fully-integrated and complex super-regional, national, and international markets. As a consequence of changes in the marketplace, the practice of law has also been affected. Professional services in the residential real estate market have become more competitive and the standards governing attorneys have shifted. Ultimately, we have argued that the totality of these changes impact on an attorney's duty to represent the client properly. In particular, we suggest that an attorney may commit malpractice when selecting or advising a client to rely upon a form of title assurance other than one coupled with the issuance of a fee owner's title insurance policy. The only exception to this duty that we recognize is one based on evidence of full notice and disclosure to the client outlining the reasons for which the client

should obtain title insurance and indicating that the client nonetheless declines coverage, contrary to the advice of counsel.

Having said this, we also want to be clear about the need for the bar to be properly educated concerning the details of title insurance. Furthermore, the bar needs to be aggressive in working with title companies to obtain affirmative coverage and the deletion of standard exceptions from coverage for homebuyers to the same extent and on the same terms as provided to lenders in their mortgage policies. This can be done at no extra cost under the standard underwriting requirements currently being used by reputable title insurance companies. If a company does not provide such coverage, their clients should drop them and give their business to companies that do provide the coverage. In the end, these companies will get more business, the client will get better risk protection, and the lawyer will add real value to the residential transaction by providing high quality and professional expertise.

