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COURT OF APPEALS DIVISION II

NO. 40752-3-II

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION II

CHICAGO TITLE INSURANCE COMPANY,
an authorized insurer,

Appellant,

v.

WASHINGTON STATE OFFICE OF
THE INSURANCE COMMISSIONER,

Respondent.

BRIEF OF *AMICI CURIAE*
STEWART TITLE GUARANTY COMPANY
AND FIRST AMERICAN TITLE INSURANCE COMPANY

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I. INTRODUCTION

Stewart Title Guaranty Company and First American Title Insurance Company (collectively "Amici") join appellant Chicago Title Insurance Company ("CTIC") in opposing the Office of the Insurance Commissioner's ("OIC") efforts to impose vicarious liability on title insurance underwriters for regulatory violations committed by independent title agencies, also referred to as underwritten title companies ("UTCs"). Amici agree that the decision of the OIC Judge should be reversed.

If CTIC or Amici violate a Washington law such as the anti-inducement statute (RCW 48.30.150) or related regulations, the OIC does and should have direct recourse against the underwriters. The question in this case, however, is whether underwriters such as Amici are properly punishable for offenses committed solely by UTCs—offenses which fall outside of the limited agency agreements between underwriters and UTCs, and as to which Amici have no prior knowledge or control.

In its briefing, CTIC has explained why, as a matter of statutory and agency law, it (and other underwriters) should not be vicariously liable for UTC violations of law, including the anti-inducement statute or regulations. In what follows, we explain why doubt as to the proper construction of relevant statutes and regulations should be resolved against vicarious liability. This brief is not designed to persuade the Court to overturn or ignore lawful regulations. Rather, it explains why the OIC's enforcement action is contrary to both: (a) the OIC's stated regulatory objective of consumer protection; and (b) the Legislature's intent that regulations governing inducements in the title insurance industry be the product of cooperative rulemaking involving insurers, real estate industries, and consumer groups.

II. IDENTITY AND INTEREST OF AMICI

Amici, together with appellant Chicago Title Insurance Company ("CTIC") and its affiliates, underwrite most of the title insurance policies issued in this state. *See* AR 470, Declaration of James E. Tompkins, ¶ 6.

Amici have obtained copies of, and are familiar with, the briefing submitted by the parties to this Court, as well as other relevant portions of the record. Amici are familiar with the scope of the arguments presented by the parties and will not unduly repeat those arguments.

Amici submit this brief to describe the systemic effect of making title insurance underwriters vicariously liable for the wrongdoing of UTCs. If faced with the cost and risk such vicarious liability imposes, underwriters will stop doing business with UTCs in less populous counties, where: (a) the economics of underwriting UTCs are already marginal; and (b) underwriters have no direct operations to take the place of UTCs. This will cut off access to title insurance in less populated counties, stymieing real estate sales and clouding titles. Thus, a decision for the OIC will, ironically, damage the very consumers the anti-inducement regulations were designed to protect.

III. ISSUES TO BE ADDRESSED BY AMICI

Will judicial imposition of vicarious liability on title insurance underwriters for illegal inducements provided by UTCs adversely affect the interests of potential home purchasers and sellers and the general public, contrary to stated regulatory and legislative objectives?

IV. STATEMENT OF THE CASE

This case arose from an OIC investigation of a UTC, Land Title of Kitsap County. AR 546, ¶ 2.2. The investigation focused on whether Land Title had violated former "anti-inducement" regulations. OIC never contacted the underwriter, CTIC, during the investigation of the UTC. OIC nonetheless requested that CTIC sign a consent order, stipulate to Land Title's violations, and pay a substantial fine. AR 514, ¶ 6. When CTIC declined, the OIC pursued disciplinary action against CTIC. AR 564-69.

An administrative law judge determined as a matter of law that the OIC lacked authority to fine CTIC for Land Title's alleged violations. AR at 278-93. The OIC petitioned for review, and an OIC Judge reversed virtually every factual finding and legal conclusion made by the ALJ. The OIC Judge ruled that a general statute defining the agency appointment process made CTIC liable for Land Title's actions. AR 118-167.

CTIC petitioned the Superior Court for review of the OIC Judge's Order. AR 2-81. The Superior Court stated, "The statute [relied on by the OIC] does not further identify what is meant by the agency," and "There is no specific statutory definition of what the scope of the agency is ...." April 2, 2010 VRP at 37:8-13. However, the Superior Court affirmed the OIC Judge. AR 173.

V. ARGUMENT

The OIC purportedly adopted the now superseded anti-inducement regulation at issue in this case to improve consumer choice in title insurance. A copy of the superseded regulation is part of Appendix A to the Respondent's Brief.

The decision of the OIC Judge, however, is inconsistent with this regulatory purpose because it undermines the longstanding and important relationships between underwriters and UTCs. In Washington's more populous counties, title insurance is available from offices directly owned by underwriters or affiliates of underwriters. In at least 14 counties, however, none of the four underwriters doing business in Washington has direct operations. *See* AR 515 (¶ 2). These counties include Asotin, Clallam, Columbia, Garfield, Grays Harbor, Jefferson, Klickitat, Lewis, Okanogan, Pend Oreille, Skamania, Wahkiakum, Walla Walla, and Whitman. In these predominantly rural counties, title insurance policies underwritten by Stewart, First American or CTIC are issued exclusively by UTCs, sometimes referred to as independent agents. *See* AR 515. The OIC also recognizes that title insurance in many counties is only available through UTCs, and not through offices owned directly by underwriters. *See, e.g.,* AR 126.[1] Typically, UTCs are locally owned and operated. *See, e.g.,* AR 501.

A. UTCs and Underwriters Have a Limited Relationship Defined by Contract.

UTCs operate through contractual relationships with one or more underwriters. *See, e.g., In re McRoyal,* 869 F.2d 1497 (9th Cir. 1989); *Wells Fargo Bank, N.A. v. Old Republic Title Ins. Co.,* 10-1087, 2011 WL 703475 (4th Cir. Mar. 1, 2011); *Bus. Bank of Saint Louis v. Old Republic Nat. Title Ins. Co.,* 322 S.W.3d 548 (Mo. Ct. App. 2010), reh'g and/or transfer denied (June 8, 2010), transfer denied (Aug. 31, 2010).

These contracts give the underwriter little control over the actions of the UTC, and no control over UTC marketing activities. AR 499(9); AR 516-517 (¶¶ 5, 6, 8). The agreements also expressly limit the scope of agency between UTCs and underwriters. "Courts throughout the country ... agree that such an express limitation on agency duties controls." *Wells Fargo Bank,* above, 2011 WL 703475;

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[1] Underwriters doing business in Washington are the two Amici, CTIC and Old Republic The latter has a very small market share. A fifth entity, Title Resources Guaranty Company, is planning to underwrite policies issued by one office in King County. It has, to our knowledge, not yet begun to do so.

see also McRoyal, 869 F.2d 1497 (general appointment provisions of California Code cannot trump express terms of agency agreement). Thus, while courts may hold an underwriter responsible for acts of a UTC "within the scope of its authority," "Is this authority without limit? Typically not." Raymond J. Werner and Scott R. Borstein, *Present Climate for Title Agents,* ABA National Institute on Attorneys' Role in Title Insurance, May 24-25 and June 14-15, 1990, at 11.[2]

Contractual limits on the scope of agency are a cornerstone of the underwriter/UTC relationship. UTCs provide escrow/closing services to buyers, sellers and lenders. The underwriter has no role in or input into, and receives no fees from, the UTCs' escrow functions. *See* AR 516 (¶ 5); AR 499 (¶ 5); *see also McRoyal*, 869 F.2d 1497 (9th Cir. 1989). Thus, when UTCs market their business they may be promoting escrow services as opposed to title work. In the current case, the record does not clearly reflect

[2] The nature of and limitations on underwriter-UTC relationships are further explained in CTIC's Opening Brief at 6-9.

that the complained-of inducements were related solely to title work, as opposed to escrow work.

UTCs perform virtually all of the pre-policy issuance work, including searching the public record and writing and issuing preliminary commitments for title insurance. After the transaction closes, the UTCs issue the title policy. UTCs keep most of the premium generated by the sale of title insurance policies. AR 516 (¶ 4).

Underwriters receive a small percentage (typically 12 to 15 percent) of title insurance premiums, but they assume most of the risk inherent in insuring titles. The typical agreement between an underwriter and a UTC imposes a small (generally $5,000 - $10,000) initial liability, comparable to a deductible, on the UTC for title losses. Except in special circumstances, all remaining title insurance liability is borne by the underwriter. *See, e.g.*, the Issuing Agency Agreement between Land Title of Kitsap County and CTIC, AR 519-523.

B. Imposition of Vicarious Liability Beyond the Agency Agreement Will Impair or Eliminate UTC Relationships.

The historical relationship between title agents and underwriters is based on a delicate balancing of interests. Operating through UTCs was at one time an efficient way for title underwriters to expand the scope of their services. That is no longer the case. Title underwriters have realized that large networks of UTCs create a serious problem: the UTCs were creating huge exposure for the title underwriters, yet the title underwriters had little control over the UTCs.

As a result, the underwriters began to reduce the number of UTCs. They have done so by (1) being more selective in their appointment of UTCs, and (2) terminating UTCs that create exposure that is not financially viable. Title underwriters now rely primarily on direct operations in all but the most rural areas of the county. Raymond J. Werner and Scott R. Borstein, *Present Climate for Title Agents,* ABA National Institute on Attorneys' Role in Title Insurance, May 24-25 and June 14-15, 1990.

The problem became more acute with the recent real estate collapse. When the real estate market was healthy and claims against title policies were relatively controlled, the underwriter-UTC arrangement (reduced in scope as it already was) worked tolerably well for the underwriters. *See id.* The recent real estate collapse, however, has increased strains on the underwriter-UTC relationship. Claims against title insurance policies, and resulting defense and loss payments by underwriters, are at an all-time high. Third-party attempts to impose liability on underwriters for remote acts of UTCs are also increasing. *See, e.g., Wells Fargo Bank,* above, 2011 WL 703475 (rejecting attempt by bank to recover from underwriter the value of mortgages purchased on the secondary market from the UTC). It is increasingly clear to underwriters that remittances of 12 to 15 percent of premiums, in an era when the premium dollar is shrinking, is insufficient to cover the increasing risk and cost inherent in insuring titles through UTCs. *See, e.g.,* "A Look Back: 10 Years in the Title Insurance Industry," http://www.thetitlereport.com, November 30, 2009.

All of this has caused underwriters to rethink the UTC model. *See id. See also* "Fraud Protection Protocols and Processes," http://www.thetitlereport.com, October 19, 2010. The current tendency is to terminate or not renew agreements with UTCs. This tendency is particularly prevalent in less populated counties, where the costs of maintaining the legally required county title plant are relatively high, but premium volumes are relatively low.[3]

As noted above, courts around the country have respected the limitations of the underwriter/UTC relationship. *Wells Fargo Bank,* above, 2011 WL 703475 (citing cases). Even so, the agency relationship in less populated counties has reached a tipping point. If underwriters are forced to become financial guarantors of UTC compliance, those underwriters will further incline toward terminating or not renewing agreements with UTCs.

Nor will underwriters have any economic incentive to set up direct operations in less populated counties. Potential revenue is low. The costs of operation, including personnel, rent, and purchasing (or leasing) and maintaining the legally required county title plant, are high. AR 469 (¶ 4), Declaration of James E.

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[3] Underwriters are not free to underwrite policies anywhere in Washington. They may only do so through direct operation offices or UTCs that own or have the rights to utilize a title plant in the county where the relevant real estate is situated. RCW 48.29.020, .040. *See* AR 469 (¶ 4).

Tompkins. Direct operations in less populated counties are, for the most part, simply not feasible.

C. The Elimination of UTC Relationships Will Harm Consumers.

If the OIC convinces this Court to impose vicarious liability, the end result will be catastrophic for owners of real property in Washington's less populated counties. Those owners likely will not have a source of title insurance. It is possible, although unlikely, that purchasers would be willing to buy real estate on the strength of a seller's warranties or an attorney's title opinions. However, banks (as well as hard money lenders) typically require a lender's policy of title insurance before making a real estate-secured loan. *See* AR 470 (¶ 5); AR 477. Thus, imposition of vicarious liability on underwriters will retard real estate sales in less populated areas, imposing significant hardships on both potential sellers and would-be buyers.

The vicarious liability that the OIC seeks to impose on underwriters will damage the very consumers that the anti-inducement and other insurance-related regulations are designed to assist. This cannot have been the intent of the Legislature when it authorized the enactment of anti-inducement regulations. Indeed, the Legislature limited enforcement to the "person" that allegedly violates a particular regulation. RCW 48.30.010(5).

It is insufficient to suggest that vicarious liability will simply incentivize underwriters to police their UTCs. ***First***, under many agreements between underwriters and UTCs, the underwriter has no right to audit to determine the appropriateness or purpose of business expenditures. AR 516 (¶¶ 5-6, 8). ***Second,*** particularly in the present economic climate, underwriters have neither the staff nor resources to perform what amounts to regular fraud audits to ferret out small expenditures for lunches, sporting events and the like.[4] Even if the underwriters could design and fund an effective audit system, it would be at substantial cost, which would only drive up the very insurance premiums that the anti-inducement regulations were designed to hold in check.[5] Courts also recognize

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[4] The 2006 OIC report, titled "An Investigation into the Use of Incentives and Inducements by Title Insurance Companies," reports that its investigation, covering only three counties, took ten months. AR 479.

[5] In *Bank of America v. Prestance Corp.*, 160 Wn.2d 560, 580-81, 160 P.3d 17 (2007), the court recognized the public importance of outcomes that result in lower title insurance premiums.

that it is not reasonable to impose a duty on underwriters to audit and supervise all acts of UTCs, particularly where a UTC may exceed the scope of its limited agency. *See Bluehaven Funding, LLC v. First Am. Title Ins. Co.*, 594 F.3d 1055, 1060 (8th Cir. 2010) ("There is no genuine dispute that Capital Title lacked actual authority to provide escrow and closing services as First American's agent. The conduct alleged in the complaint falls outside the scope of Capital Title's authority, and the vicarious liability claims necessarily fail as a matter of law").

Amici support industry accountability. But, if an underwriter itself violates the law, it is solely and directly accountable. *See* RCW 48.30.010(5). The OIC fails to explain why, as a practical matter, a UTC should not be held solely accountable for its own alleged misdeeds. The OIC also fails to explain why, if it believes vicarious liability is necessary, it cannot work with representatives of the title and real estate industries, along with consumer groups, to develop rules that fairly address the issue. In fact, the Legislature recently directed that, in adopting rules pertaining to inducements in title insurance, "the commissioner shall work with representatives of the title insurance and real estate industries and consumer groups in developing the rules." RCW 48.29.005(5). Instead, the OIC has taken the opposite approach.

VI. CONCLUSION

If the OIC unilaterally imposes vicarious liability on title insurance underwriters, portions of this state will lose access to title insurance. This is not what the Legislature intended when it enacted anti-inducement and similar statutes, nor is it consistent with the policy behind anti-inducement regulations. This Court should reject the OIC's position, leaving underwriters and UTCs liable for their own violations. Amici join in requesting reversal of the OIC Judge's decision.

Respectfully submitted this 10th day of August, 2011.

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