

April 2014

TOP CASE LAW OF 2013



OCTOBER
RESEARCH
LLC



THE LEGAL
DESCRIPTION

buyer, provided no down payment. Since he would not lose any of his own money by defaulting, Ray had no incentive to pay his mortgages and, in fact, did default on the loans after only a few payments. Without a bona fide mortgagor, the scheme was set up to guarantee a default. PTS's conduct during the closing caused BankUnited to obtain two mortgages without a bona fide mortgagor, and to provide funds to members of a mortgage fraud scheme. Therefore, BankUnited did not receive the bona fide mortgage for which it bargained and PTS's failure during the closings affected the enforceability of the liens under the CPLs."

The FDIC also claimed that PTS's handling of the closing documents submitted to BankUnited amounts to dishonesty.

"Although circumstantial, I find a preponderance of the evidence indicates Bensema not only facilitated the scheme, but also was complicit in it," the court stated. "This was classic mortgage fraud scheme. Ray was a straw buyer. He did not negotiate the prices, he did not negotiate the terms of the mortgage, he had little familiarity with the property, and he did not put any money into the transaction. He claimed to make over twice his real income on his mortgage application. Ray had no Realtor, at least

not in any traditional sense of the word. **Craig Turturo**, who claimed he was simply helping out a fellow firefighter, but who was the son of the man who selected PTS and the brother of the appraiser of the properties, testified falsely concerning his involvement in the case."

First American asked the court to find that the FDIC failed to prove that BankUnited would not have issued the loans had it known about the wire transfers. Middlebrooks disagreed, holding that the FDIC did not have to prove that BankUnited would not have funded the loans had it known of the wire transfers.

"Instead, the FDIC had to show a causal connection or relationship between PTS's conduct and the injury," he said. "The FDIC has done so. PTS's failure to abide by BankUnited's closing instructions and PTS's engagement in dishonesty resulted in Old Bank funding two loans to a straw buyer with no skin in the game, who defaulted less than six months after the closings.

"By refusing to reimburse the FDIC for PTS's conduct that triggered indemnification, First American breached the CPLs," Middlebrooks stated. "Therefore, I find that the FDIC met its burden in demonstrating that First American breached the CPLs at issue in this matter."

Court reverses \$1M judgment in defense suit

Liberty National Enterprises L.P. v. Chicago Title Insurance Co. (Second District Court of Appeal of California, No. B234341)

A California appellate court reversed a \$1 million judgment against Chicago Title Insurance Co. for breach of title insurance policy in a case in which the insured-plaintiff alleged the insurer breached the duty to defend in a quiet title action brought in the course of a dispute among siblings regarding the ownership of a downtown Los Angeles commercial property known as the Broadway Trade Center (BTC).

The facts

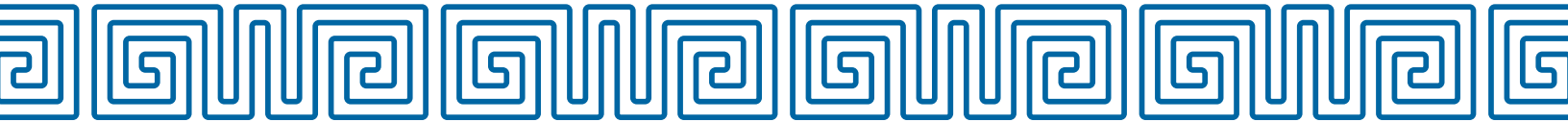
From at least 1988 to March 1994, the BTC was owned by a limited partnership whose limited partners were a married couple (**Alber** and **Parvaneh PartIELLY**) and their son, **Danny PartIELLY**. The PartIELLY family encumbered the BTC property with two deeds of trust: A first position deed of trust given by Union Federal Bank (securing a loan of more than \$16 million), and a second position loan from a general partnership known as American Financial Services (AFS). The two partners

who made up AFS were Parvaneh PartIELLY's brothers, **Shahram** and **Shahriar Afshani**.

AFS (namely, brothers Shahram and Shahriar Afshani) agreed to sell to their sister, Parvaneh, and her husband, Alber, a 9.5% interest in the AFS loan (and the associated second-position deed of trust). The Afshani brothers and the PartIELLYs memorialized this contract in a Loan Participation Agreement dated October 24, 1990. Thus, as of that date, the PartIELLY family not only owned the BTC (through their limited partnership with their son), but they also had a 9.5% interest in the second-position deed of trust recorded against the BTC.

In March 1993, the PartIELLYs' partnership (which owned the BTC property) filed for bankruptcy, and defaulted on both the first-position loan (from Union Federal Bank) and the second-position loan (from AFS – Parvaneh's brothers' partnership).

In addition to the two deeds of trust from Union Federal Bank and AFS, the BTC property was also encumbered with four ground leases. When the PartIELLYs defaulted on their loans, Shahram Afshani (one of the partners in second-position lender AFS) attempted to acquire the



four ground leases, believing that by doing so, he could “jump” Union Federal Bank’s priority. Ultimately, using money from another relative (**Saied Eshaghzadeh**, as well as Saied’s family), Shahram was able to acquire three of the four ground leases through an investment vehicle known as Security Trust Company. Union Federal Bank caught wind of Shahram’s plan (which Shahram had kept secret from his sister and Union Federal Bank), and Union Federal Bank acquired the fourth ground lease by doubling Shahram’s bid for it.

In July 1994, Union Federal Bank foreclosed on its first-position deed of trust, and took title to the BTC property, excluding that portion subject to the ground leases (which Shahram – through Security Trust Company -- had acquired). The foreclosure wiped out all junior interests in the BTC property, including the interests created by the trustee’s deed upon sale from the AFS foreclosure (i.e., the trustee’s deed which granted AFS a 90.5% interest in the BTC and the Partiellys a 9.5% interest in the BTC).

Shahram formed Liberty National Partners, LP (“Liberty”) – a limited partnership between Shahram, his brothers (Shahriar and Parviz), Saied Eshaghzadeh and other members of the Eshaghzadeh family. Liberty purchased Union Federal Bank’s interest in the BTC (which bank, parenthetically, had by then been taken over by the FDIC). Liberty also acquired the interests which Security Trust Company had previously purchased. Ultimately, Liberty became the owner of the BTC property by January 1998. In other words, as a result of his financial maneuvering, Shahram, his brothers and other relatives (namely, the Eshaghzadehs) took over the BTC property from their sister, Parvaneh (and her husband and son). Once Liberty consolidated its ownership interest in the BTC property, it purchased an owner’s policy of title insurance from Chicago Title.

In November 2001, Alber and Parvaneh Partielly filed a lawsuit against Parvaneh’s brothers (including Shahram) and the brothers’ various entities (including Liberty – by then the owner of the BTC property), claiming that the defendants had used an interlocking network of fictitious entities to effectively deprive Alber and Parvaneh of their benefit of their 9.5% interest in the original AFS loan (and thus a 9.5% interest in the property). The First Amended Complaint in the Partielly lawsuit stated causes of action for breach of contract (i.e., the loan participation agreement), common counts, fraud, declaratory and injunctive relief, quiet title, breach of fiduciary duty, accounting and unjust enrichment.

Liberty tendered the defense of the Partielly action to Chicago Title in June 2002, claiming that the quiet title cause of action triggered coverage under the owner’s policy

of insurance which Liberty purchased in 1998. Chicago Title denied coverage. Liberty retained its own counsel to defend the Partielly action, which ultimately settled.

In November 2007, Liberty sued Chicago Title for breach of policy, bad faith and declaratory relief. After a trifurcated trial (in which the issues of policy coverage, damages under the policy and bad faith were each tried separately), the Court entered judgment in favor of Liberty on the breach of policy claim (and awarded damages in excess of \$1 million) and in favor of Chicago Title on the bad faith claim. Both sides appealed.

Court decision

The appellate court held that Chicago Title had no duty to defend the third party lawsuit brought by the Partiellys. This holding rendered Liberty’s appeal regarding bad faith moot. The court reversed the judgment against Chicago Title and directed the trial court to enter judgment for Chicago Title.

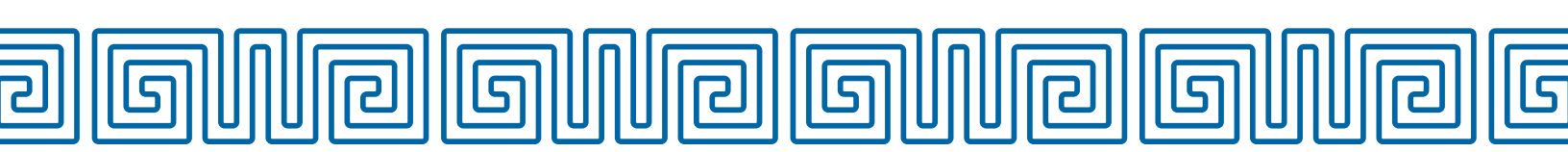
Chicago Title argued that this case is just like *Moskopoulos* in that the Partielly action did not allege defects in title, but tortious conduct in the manner in which Liberty acquired title.

Liberty countered that the Partielly complaint is internally inconsistent about whether Liberty had 100 percent title to the property. It pointed to allegations suggesting that the Partiellys actually owned a 9.5 percent interest in title to the property. Liberty acknowledged that the Partielly action alleged tortious conduct by the insured in personal dealings, but it maintained that the quiet title claim made all the difference in distinguishing the case from *Moskopoulos*.

“We are not persuaded by Liberty’s arguments and its attempt to distinguish *Moskopoulos*. The *Partielly* action was not covered by the insuring clause of Liberty’s policy,” the court stated. “To review, the insuring clause of the policy insured against loss sustained because of title to the estate or interest being vested other than in Liberty, or any defect in or lien or encumbrance on the title. According to our Supreme Court, the words defective title mean that the party claiming to own has not the whole title, but some other person has title to a part of portion of the land. As in *Moskopoulos*, the Partielly action did not allege a defect in Liberty’s title, but tortious conduct in the manner in which Liberty acquired title. The allegations of tortious conduct should be apparent from our detailed discussion of the Partielly action in the factual background section.

“The Partiellys alleged that they had a 9.5 percent interest in title to the BTC property by virtue of the loan participation agreement, but they were deprived of that interest when the defendants excluded them from ‘downstream transactions’





in violation of a purported partnership agreement, and fraudulently represented that the BTC property was ‘no good’ and that the defendants intended to walk away and take no additional or active part in it,” the court continued. “The *Partielly* action acknowledged that Liberty had full and complete title to the BTC property, and it sought to restore a 9.5 percent interest of which the Partiellys were wrongfully deprived. This situation is no different than *Moskopoulos*, in which the insured held legal title to the subject property, but the sellers sought to regain title (through a constructive trust or rescission) because the insured’s alleged tortious conduct deprived them of it.

“We do not see inconsistencies regarding whether Liberty had full and complete title. First, Liberty’s reliance on the Partiellys’ allegation that Union Federal Bank’s foreclosure did not wipe out all the ownership interests is unconvincing,” the court stated. “Liberty and Chicago Title stipulated at trial that the Union Federal Bank foreclosure in fact wiped out all junior interests in the BTC property, which would have included the Partiellys’ 9.5 percent interest in the second trust deed. And Avery testified that when he was making his coverage decision, he understood the foreclosure had wiped out the interests of the second trust deed. Although this stipulated fact was extrinsic to the Partielly FAC, we (and the insurer) may rely on extrinsic facts to determine whether there was coverage.”

Impact on the industry

Kevin Sinclair, partner at the law firm of Early Sullivan Wright Gizer & McRae LLP said that the Court of Appeal’s reaffirmation of *Safeco v. Moskopoulos* will have significant

implications for California title insurers’ abilities to deny certain claims.

“Before *Liberty National*, insureds can and would argue that there was a gap in California law left by *Safeco v. Moskopoulos* for situations like this one – where the gravamen of a lawsuit against an insured challenged ‘equitable title,’ but the action was styled as a challenge to ‘legal title.’ This was apparently where the trial court in *Liberty* took a wrong turn. The Court of Appeal closed whatever gap may have existed by confirming that the duty to defend hinges on the gravamen of a third party claim against an insured, and not merely its form.”

Eric Early, managing partner at Early Sullivan Wright Gizer & McRae LLP, agreed.

“*Liberty National* arms title insurers with a much stronger basis to deny claims like this one, where someone ostensibly tries to convert their title insurance policy into a form of comprehensive liability coverage, simply because there is some attenuated connection between a tort claim asserted against an insured and real property. We think that this is the correct ruling because it lines up with what title insurers expect to cover and what consumers expect title insurers will cover when they buy a policy.”

Early noted that the *Liberty National* case has already had an impact on cases in the state – in a case his firm is handling, the Court in *Metzger v. Santos* entered a judgment of dismissal after sustaining a demurrer without leave to amend based largely on the Court of Appeal’s decision in *Liberty National*. That case is currently pending appeal.

First American continues to wage battle over alleged RESPA violations

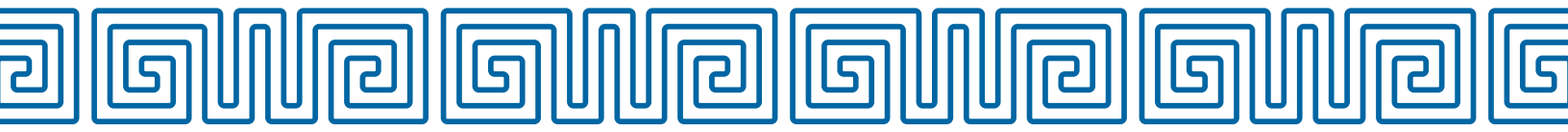
The *Edwards v. First American* case became well known in June 2011 when the U.S. Supreme Court decided to review the controversial matter. The 9th U.S. Circuit Court of Appeals had held that a private purchaser of real estate settlement services has standing under RESPA to sue for an alleged violation even if actual damages are absent, and the case was appealed to the high court. A year after granting *certiorari*, the Supreme Court declined to review the merits of the case, and the 9th Circuit’s decision was, in essence, upheld.

That did not, however, end the matter. Although the 9th Circuit’s decision was the final say regarding the standing issue, it did not determine whether the plaintiff, **Denise**

Edwards, won her case against First American on its merits. The parties had to go back to the trial court to finish arguing the rest of the case.

Edwards filed a class action complaint against First American Corp. and First American Title Insurance Co. in 2007, alleging that the company paid referral fees to title agencies in violation of RESPA. Specifically, Edwards alleged that First American agreed to purchase an interest in various title companies and then required those agencies to enter into referral agreements.

Edwards requested that the trial court certify a nationwide class that consisted of consumers who used services of



the title agencies affiliated with First American, which the U.S. District Court for the Central District of California denied. The court also did not allow Edwards to search for evidence of a nationwide class during discovery. The issue was appealed to the 9th Circuit, which reversed part of the lower court’s decision, finding that Edwards should have been allowed to conduct nationwide discovery.

The case was sent back to the district court. On remand, the court again denied certification of a nationwide class. The court determined that in order to prove a RESPA violation, Edwards was required to show that First American overpaid for the interest it purchased in the title agencies. The overpayment would show, according to the court, that a thing of value was exchanged for referrals. The district court also found that it would need to determine on a case-by-case basis if each member of the proposed nationwide class was referred, as defined under RESPA. The court believed that each class member would need to prove not only that they were referred but that the referral influenced them when deciding on a settlement service provider.

The issue was sent back up to the 9th Circuit.

First American filed its reply brief on Feb. 20, arguing that a nationwide class should not be certified in this matter and stating that Edwards’ argument is unfounded.

“The district court reasonably concluded that a nationwide class action is not an appropriate way to approach this swirling miasma of litigation because common issues do not predominate,” First American argued. “Edwards pitched certification based on an over-simplified fact pattern that does not exist: that First American overpaid each of the 38 title agencies for an ownership interest to obtain an agreement from each title agent to exclusively ‘refer’ customers to First American Title Insurance Co. From that fictional premise, Edwards sought to assume that when each member of her putative class paid for title insurance, it was because the title agents referred them pursuant to the exclusive referral agreement.”

The company argued that it purchased ownership in some of the title companies but also started some of the companies from scratch. First American contended that there was no evidence it overpaid for any of the title agencies. It also said that the agreements adopted by the title agencies were not exclusive, and some of the agencies reserved the right to direct business to other underwriters.

The Consumer Financial Protection Bureau (CFPB) filed an *amicus* brief in the case in November 2013, arguing the district court’s decisions were wrong. According to the

bureau, the court misunderstood the safe harbor in the RESPA Section 8 (c)(2) that allows payments made for goods and services that are actually rendered. Section 8(c)(2) states that nothing in Section 8 should be construed as prohibiting “the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed.”

The bureau disagreed that Edwards was required to show First American overpaid for its ownership interests in order to show the referrals violated RESPA, urging the 9th Circuit to recognize that the safe harbor did not apply to the facts in the case. The bureau argued that the safe harbor does not allow a company to enter into agreements that violate RESPA’s ban on paid referrals. The issue, said the bureau, was not whether First American overpaid for its interest in the title agencies, but instead, was whether the company paid a thing of value for the referral of settlement service business.

First American strongly discouraged the 9th Circuit from relying on the CFPB’s brief in order to decide in Edwards’ favor.

The company urged the 9th Circuit to affirm the district court’s denial of Edwards’ motion for certification of a nationwide class.

Frances X. Riley, partner at the Princeton, N.J.-office of Saul Ewing, said that the CFPB’s *amicus* brief in Edwards is a clear indication that the CFPB believes that RESPA provides for standing even when the only alleged injury is being a party involved in a transaction arising from a purported impermissible referral (one for which payment was made). He said the CFPB and the plaintiffs’ bar believe the goal of RESPA is to protect consumers from a skewed marketplace which they believe inherently results from affiliated business arrangements and the referrals that result from such arrangements. It is based on this position, Riley says, that the CFPB tries to fund support for its argument that the trial court erred in ruling that the plaintiffs have to prove First American’s overpaid for its investment in the joint venture and that their decision to select the title company was affirmatively influenced by the referral they received from the defendant.

“Its *amicus* brief in *Edwards* is a primary example of the CFPB’s strategy of attempting to use the courts to redefine RESPA’s public policy protections in a manner that is consistent with the Bureau’s subjective goals without having to go through the required rule making procedure” he said.

