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Seventeen Worthless Mortgages



COMMENTARY: by [JONATHAN FOXX](#)

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On March 1, 2011, the US Court of Appeals (Fourth Circuit) filed a Per Curiam opinion. In *Wells Fargo Bank, N.A. v Old Republic Title Insurance Company*, Wells Fargo sought to recover the value of "seventeen worthless mortgages" - the Court's own words! - it purchased from Financial Mortgage, Inc. (FMI), a mortgage banker, in the secondary mortgage market. The scheme involved Title Pro, an agent of Old Republic, colluding with FMI to fraudulently close the real estate transactions underlying Wells Fargo's mortgages. Wells Fargo claimed that Old Republic was contractually bound to indemnify Wells Fargo for its losses.

The Court ruled in favor of Old Republic! Let's learn why.

Commentary and Outline

This Commentary offers a brief outline. I am leaving out citations, where possible, for ease of reading. This outline is not meant to be comprehensive, authoritative, or relied upon for legal advice. It offers only a brief synopsis of the argumentation. For citations, exhibits, and argumentation, read the judicial decision (below).

The Scheme

FMI originated mortgages and drew on its warehouse lines from several financial institutions. After the warehouse lenders advanced funds to FMI for a mortgage loan, FMI would then sell the mortgage to secondary investors, use the proceeds to pay back the warehouse lenders, and thereby replenish its lines of credit.

So far, so good.

But this is where the plot thickens.

Beginning May 2004, Wells Fargo entered into a standard Loan Purchase Agreement with FMI. This Agreement set forth the terms required by Well Fargo to purchase from FMI numerous residential mortgage loans secured by a note and deed of trust on real property, properly recorded and free from prior liens.

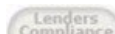
However, the very mortgages purchased by Wells Fargo from FMI failed at their inception, because FMI misrepresented to Wells Fargo that the mortgages were recorded in Virginia's public records system, providing Wells Fargo with first and exclusive priority over all other creditors. Eventually, Wells Fargo discovered that it actually had unsecured and/or subordinate positions on these loans, because they were not recorded nor free from the prior liens.



An Agency Agreement

Old Republic, like most title insurance companies, appoints agents to act on its behalf to sign, countersign and issue commitments, binders, title reports, certificates, guarantees, title insurance policies, endorsements, and other agreements under which the insurer assumes liability for the condition of title.

In Old Republic's Agency Agreement with TitlePro, the latter was expressly prohibited from acting as an agent of Old Republic when, on some occasions, TitlePro might serve as a settlement agent. That is, when TitlePro performed such services, the Agency Agreement expressly prohibits TitlePro from acting as an agent of Old Republic.


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FMI and TitlePro - Two Ways to Collude

Version One (Variations on a Theme) - 3 Bogus Mortgages

- 1) FMI secures a buyer of land or a refinancing opportunity.
- 2) FMI then sends the necessary mortgage documents to TitlePro.
- 2) TitlePro then uses the loan documents to create the appearance of loan closings (i.e., completing a HUD-1 Settlement Statement, et cetera).
- 3) TitlePro is now able to obtain funds from FMI's warehouse lenders (which does not include Wells Fargo).
- 4) After obtaining the funds, TitlePro fails to use those funds to clear title or pay off the pre-existing mortgage.
- 5) TitlePro transfers the funds to FMI.
- 6) For many transactions, FMI also creates multiple, unrecorded "first" mortgages on each property by having borrowers sign multiple sets of "original" loan documents at closing. (I'll call these "first" mortgages "bogus mortgages.")
- 7) FMI fabricates the notes.
- 8) FMI sells these unrecorded bogus mortgages to several secondary investors, including Wells Fargo.
- 9) In each of these transactions, FMI fails: (a) to disclose the existence of the other bogus mortgages with prior liens to purchasers of these mortgages and (b) to record the mortgages it subsequently sold.
- 10) Wells Fargo deals with FMI exclusively, sending payment for the notes directly to FMI's accounts.
- 11) Wells Fargo does not interact with TitlePro or Old Republic in any way.

Version Two - 14 Bogus Mortgages

- 1) TitlePro fills out a HUD-1 Settlement Statement and receives loan proceeds from the warehouse lender.
- 2) The HUD-1 Settlement Statements requires TitlePro to use these funds to pay off the prior mortgages on the properties.
- 3) TitlePro fails to pay off the prior mortgages and release them of record.
- 4) TitlePro also fails to record the new mortgage in favor of FMI that "secured" the notes eventually sold to Wells Fargo.
- 5) In each of these transactions, FMI fails: (a) to disclose the existence of the other bogus mortgages with prior liens to purchasers of these mortgages and (b) to record the mortgages it subsequently sold.
- 6) Old Republic does not issue policies on these transactions, because Old Republic's Commitment letters requires the prior mortgages to be "paid and released of record" as a condition of issuing the title insurance policies.
- 7) For some of these transactions, Old Republic also issues a standard-form closing protection letter (CPL), agreeing to reimburse FMI for losses arising out of an issuing agent's misconduct in closing a transaction.



Scammed!

Wells Fargo now possesses seventeen worthless mortgages, all of which are presently in default.



District Court

When Wells Fargo began this action back in March 2009, it alleged six claims: (1) breach of contract; (2) a business conspiracy in violation of Virginia Code; (3) common law civil conspiracy; (4) fraud; (5) violations of Virginia's Wet Settlement Act, and (6) negligence. For all but the breach of contract claims, Wells Fargo alleged that TitlePro acted as Old Republic's agent when it closed the disputed transactions.

The District Court granted summary judgment to Old Republic because:

- 1) It rejected Wells Fargo's contention that Virginia's Consumer Real Estate Settlement Protection Act (CRESPA) made Old Republic liable, reasoning that CRESPA does no more than authorize non-attorneys, including title agents, who meet specific statutory conditions to serve as settlement agents.
- 2) It held that TitlePro did not have actual agency authority because the Agency Agreement explicitly prohibited TitlePro from acting as a settlement agent on Old Republic's behalf.
- 3) In accordance with Virginia law, it rejected Wells Fargo's theory of apparent authority, reasoning that Wells Fargo did not reasonably rely on Old Republic's conduct or statements allegedly cloaking TitlePro with apparent authority to act as a settlement agent on Old Republic's behalf.

For these reasons, the District Court also granted summary judgment to Old Republic on the conspiracy, Wet Settlement Act, and fraud claims.

Plus:

- 4) The District Court rejected the breach of contract claim, reasoning that Old Republic could assert the same defenses against Wells Fargo as it could against the assignor of the contract, FMI, and one such defense -- fraud -- shielded it from contractual liability. (The District Court also ruled that the negligence claim failed because, in negligence claims, the

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common law duty protecting person or property does not extend to Wells Fargo's acquisition of worthless notes. Wells Fargo did not challenge this holding on appeal.)

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Appeals Court

Wells Fargo appealed, arguing that:

- (1) an assertedly "ambiguous" agency agreement and Old Republic's course of conduct raise genuine issues of material fact as to the scope of TitlePro's agency;
- (2) the District Court misinterpreted CRESPA;
- (3) TitlePro furthered the conspiracy by issuing title insurance instruments, as authorized by Old Republic, thus making the latter liable in conspiracy; and,
- (4) a provision in Old Republic's title insurance policy absolved Wells Fargo (an innocent purchaser for value) of any fraud-based defenses Old Republic may have against FMI.

Yet the Appeals Court upheld the District Court's ruling. Why?



Back to that Agency Agreement

So, why did the Appeals Court affirm the District Court?

Because there are two provisions of the Agency Agreement, though seeming to conflict with each other, which rather serve separate, but complementary ends.

On one hand, a section requires TitlePro to record documents "necessary to insure the interest," not every document necessary to close the transaction. The primary purpose of this settlement-like duty is to "minimize the risk of loss under the title insurance policies," not create a general agency relationship capturing all the agent's settlement activities.

On the other hand, in another section, Old Republic unequivocally withholds consent for TitlePro to act as an agent when TitlePro performs "any escrow, closing or settlement" services. Courts throughout the country, including those interpreting Virginia law, agree that such an express limitation on agency duties controls.

Accordingly, Wells Fargo ran out of luck and Old Republic was off the hook.



Justice Served?

On November 13, 2008, the owner of FMI, Vijay Taneja, pled guilty to one count of conspiracy to commit money laundering in violation of federal law and received a sentence of 84 months imprisonment, to be followed by three-years of supervised release.

But what about that little matter of those "seventeen worthless mortgages?"

[Click for the Per Curiam Opinion.](#)

What do you think?

I would welcome your comments.

Please feel free to email me at any time.



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