Escrow Agent Liability and Fiduciary Duty

2016 Texas Land Title Institute
Dec. 8-9, 2016
San Antonio, Texas
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- 2008-14, Mr. Irelan has been recognized as a SuperLawyer by Texas Lawyer
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- AV Peer Review Rating with Martindale-Hubbell (highest rating for ethics and ability)
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BOARD CERTIFICATIONS (Texas Board of Legal Specialization)

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- Residential Real Estate Law

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- U.S. District Court for the Southern District of Texas
- U.S. District Court for the Northern District of Texas
- U.S. District Court for the Western District of Texas
- U.S. District Court for the Eastern District of Texas
- U.S. Fifth Circuit Court of Appeals
- United States Supreme Court

MEMBER

- State Bar of Texas (since November 7, 1986)
- Houston Bar Association, Member, Litigation and Real Estate Sections
- Houston Bar Foundation, Life Fellow
- Texas Land Title Association, Member
  - Judiciary Committee, Texas Land Title Association (2006-10, 2011, Chairman)
  - Legal Issues Committee, Texas Land Title Association (2009-11)
  - Institute Committee, Texas Land Title Association (2009-11)
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OTHER PROFESSIONAL DISTINCTIONS

George Washington School of Law Alumni Board of Directors
- Executive Committee, 2010
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BAR ADMISSIONS

- All Texas State Courts
- U.S. District Court for the Southern District of Texas
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- U.S. District Court for the Western District of Texas
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- Texas Land Title Association, Member
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  - Editor, E-Newsletter for the Trial Practice Committee

PUBLICATIONS

- Five Tips for Developing and Presenting Visuals to Judges and Juries, ABA Trial Practice Committee Newsletter (2015)
- Understanding the Basics of Texas Title Insurance and Escrow Agency, Representing Consumers in Texas Real Estate Transactions (2014)
- The Recoverability of E-Discovery Costs in Federal Litigation, ABA Trial Practice Committee Newsletter (2014)
- Claim Investigations With an Emphasis on Technology, ABA Mid-Winter Annual Program of the Fidelity & Surety Law Committee (2013)
- E-Discovery: What Every Claim Professional Needs to Know When Handling Fidelity Bond Claims, ABA Fall Program of the Fidelity & Surety Law Committee (2012)
I. INTRODUCTION

As outside claims counsel for title insurers, our firm is often asked to handle claims involving escrow disputes. The claims vary broadly. Some claims are straightforward and routine: interpleading earnest money in dispute between the buyer and seller on a busted deal. Other claims are significantly complex: allegations of failure of the closer to comply with the closing instruction letter from the lender. Some claims are alarming: an agent absconding with substantial escrow funds. And others are benign: seemingly justified delays in disbursement of settlement funds. In every instance, however, the escrow claim is hallmarked by the special duties of the escrow officer to the participants in the transaction. This paper explores the duties imposed upon the escrow agent, the role of the escrow agent in real estate transactions, and claims that typically arise from the escrow relationship. Each of these topics is examined from the perspective of the trial lawyer who must either defend or prosecute claims involving escrow.

II. ESCROW AGENT'S DUTIES

An escrow agent’s duties flow from three primary sources: (1) the common law developed by the courts; (2) Texas statutes and rules promulgated by the Texas Department of Insurance; and (3) the escrow agreement agreed to by the parties.

A. Common Law Duties

Texas courts will imply an escrow agency relationship by conduct absent a formal escrow agreement where the third party accepts documents, funds, or property for disbursement at closing. An escrow transaction is a fiduciary relationship that imposes “special duties” in common law for the escrow agent. Unlike other fiduciary relationships, an escrow agent owes fiduciary duties to all parties to the transaction. The duty to all parties exists regardless of whether all parties pay the escrow agent for its services. The escrow agent’s fiduciary duties do not extend, however, to non-parties to the transaction. Because an escrow agent holds concurrent duties to both the buyer and seller, the scope of the duties is often described as “special.” The duties are special because they differ from the normal

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5 Dorsett Bros. v. Safeco Title Ins. Co., 880 S.W.2d 417 (Tex. App.—Houston [14th Dist.] 1993, pet. denied) (escrow agent not liable to subcontractor, who was not a party to the contract nor a third party beneficiary).
fiduciary duty of a general agent, such as an employee or trustee, whereby the duties are owed only to a single principal.

Courts have not been consistent in how they describe an escrow agent’s duties. The leading case from the Texas Supreme Court describe the duties owed by escrow agents to buyers and sellers of real property to be the duties of loyalty, full disclosure, and the exercise of a high degree of care in conserving the funds placed in escrow.\(^6\) Other courts have described an escrow agent’s duties as being “strictly limited and the scope of the agent’s duties are defined by the escrow agreement.”\(^7\) And some courts use both descriptions without acknowledging any tension between them.\(^8\) Despite these potentially inconsistent descriptions of the duties, there is still a consensus as to some aspects of an escrow agent’s duties. Those will be covered first.

1. Duty to Carry Out Terms of Escrow Agreement

Where there is a formal escrow agreement in place, an escrow agent has the duty to follow the agreed terms of the underlying contract and the absolute duty to carry out the terms of the agreement creating the escrow agency.\(^9\) Ordinarily, the requirement to follow the terms of the escrow is not problematic. Issues arise, however, when lenders deliver, the day before or on the day of closing, closing instruction letters that require the closer to perform a dizzying array of tasks to close the transaction. Often, the closing instruction letters require the closer to provide various assurances and affirmations of fact to the lender about the closing. For example, Wells Fargo has required closers to disclose the following:

Any material fact that may have an impact on the Lender’s decision to make the Loan. A material fact includes but is not limited to, any significant information on changes in the value or title of the Property, financial condition of the Borrower, changes in marital status or the legal status of the Borrower, changes to the sales contract (if a purchase), changes to the financing, Borrower or Seller bankruptcy, enforcement of creditor’s rights against Borrower or Seller, or any other indication of suspicious activity.

Many title agents respond to this type of requirement by sending a responsive letter that details what obligations the closer can accept in regard to the closing. Prudent closers rely on Procedural Rule P-35 which prohibits an escrow officer from issuing any form of verbal or written guarantee, affirmation, indemnification, or certification of any fact, aside from a statement the transaction closed and has been funded, issuance of a closing protection letter or affirmation that copies of records from

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the closing are true and correct. The responsive letter limiting the closer’s obligations probably becomes the operative escrow agreement, though no reported cases in Texas addressed this issue. If the closing instruction letter is viewed as an offer and the counter-letter is viewed as a counterproposal, then the lender’s acquiescence in closing thereafter would indicate acceptance of the terms of closing. In any event, a closer’s handling of closing is far more defensible when the closer has responded to an onerous closing instruction letter with a limiting letter.

2. Duty to Conserve and Properly Disburse/Duty of Care

At least one Texas court has held that escrow agents must exercise a high degree of care to conserve the items deposited into escrow and disburse escrowed items only to those parties who are entitled to receive them. Consequently, an escrow agent will be liable for misapplication of monies deposited into escrow. Escrow agents must act with diligence and prudence in conserving documents or funds deposited in escrow and in delivering or disbursing such items only as instructed.

Similarly, an escrow agent who fails to timely record title documents executed at closing faces liability under the terms of the escrow relationship. Claims arise when closers delay recordation and intervening liens or other title impediments are recorded in the gap period. Escrow agents can even be held liable for recording title documents prematurely. Defending an escrow agent’s failure to timely record title documents is difficult. Closing instruction letters consistently require closers to record title instruments immediately upon closing the transaction. When an intervening lien has been recorded due to a delay in the closer’s recordation of title instruments, the delay is rarely excusable or unavoidable.

Escrow agents must verify the funds are received from the correct party. Lenders rely on closers to advise if closing funds originate from third parties rather than the borrower. Sources other than the borrower may indicate the funds are borrowed without disclosure, facts which could affect underwriting of the loan. Additionally, checks must be deposited by the escrow agent within a reasonable time after receipt, or the agent may be liable if the checks are stale or dishonored when finally deposited. The classic scenario in which this problem arises is when a buyer delivered earnest

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10 See City of Fort Worth v. Pippen, 439 S.W.2d 660, 664 (Tex. 1969) (title insurance company and agent liable for converting funds deposited by seller, which were misdirected after the funds were sent to title company).
11 Texas First Nat’l Bank v. Ng, 167 S.W.3d 842, 857 (Tex. App.—Houston [14th Dist.] 2005, pet. granted, judgm’t vacated w.r.m.) (escrow agent is liable for any deposit that is not held or delivered in accordance with escrow agreement).
12 Lawyers Title Co. of Houston v. Author, 569 S.W.2d 578 (Tex. 1978).
13 See, e.g., Lacy v. Tisor Title Ins. Co., 794 S.W.2d 781, 786 (Tex. App.—Dallas 1990), writ denied per curiam; 803 S.W.2d 781, 785 (Tex. 1991) (escrow agent liable for failing to record title documents); Lawyers Title Co. of Houston v. Author, 569 S.W.2d 578 (Tex. 1978) (escrow agent’s delay of a year in recording release of mortgage constituted breach of duty, especially in light of escrow agent’s senior officer’s assurance to the parties that “everything necessary to the closing had been accomplished”); Boatright v. Texas American Title Co., 790 S.W.2d 722 (Tex. 1990) (escrow agent’s failure to record documents constituted violation of fiduciary duty).
16 See Chilton v. Pioneer Nat’l Title Ins. Co., 554 S.W.2d 246 (Tex. Civ. App.—Waco 1977, writ ref’d n.r.e.) (title company breached its duties as an escrow agent when it failed to deposit two escrow checks as done in normal course of business).
money but then gets cold feet on the transaction. The buyer either stops payment on the earnest money check or withdraws funds from the drawing bank account so that the check is dishonored. The aggrieved seller will hold the closer liable for the delay in depositing the earnest money check immediately upon receipt.

An escrow agent should not disburse funds without the parties’ approval. If an agent disburses earnest money improperly, he may be required to reimburse the damaged party if the funds cannot be recovered. For example, in *Commercial Escrow Co. v. Rockport Rebel, Inc.*, the court held the escrow agent liable for the loss of $25,000 in earnest money because it was improperly disbursed. In that case, Rockport Rebel entered into a contract to sell a Best Western motel to TDL Development Company (“TDL”). TDL did not have the means to deposit the $25,000 loan commitment fee in escrow required by TDL’s lender, so Rockport Rebel agreed to deposit $25,000 in escrow pursuant to an addendum to the contract. The addendum provided that if the sale did not close, the earnest money would be refunded in full to Rockport Rebel. Before closing, the escrow agent released the $25,000 to TDL’s lender. The deal ultimately failed and the lender went bankrupt. Rockport Rebel sued the escrow agent for improper disbursement of escrow proceeds. At trial, the jury found the escrow agent was negligent and the court of appeals affirmed: “In short, Commercial Escrow failed to follow adequate procedures to insure the protection of Rockport Rebel’s funds,” and therefore, “[w]e hold there is sufficient evidence to show appellants were negligent and that this negligence was the proximate cause of Rockport Rebel’s damages.”

Standard practice in real estate transactions requires the parties to execute a final settlement statement reflecting the intended disbursement of funds. In such circumstances, settlement funds must be disbursed in accordance with the executed settlement statement. Problems arise when the closer is requested to disburse net sale proceeds not to the seller but to third parties not reflected on the settlement statement. In the 2000s, many flip transactions used settlement funds to fund related transactions, including the A to B transaction in an A to B to C flip. Failure of the closers to disclose such related transfers of settlement proceeds exposed them to liability to lenders. It is certainly difficult to defend a closer who has failed to disburse funds in accordance with the settlement statement, even when the reason for the deviation is benign.

3. **Duty of Loyalty**

An escrow agent owes a duty of loyalty to the contracting parties. As such, the escrow agent must act in good faith and solely in its principals’ best interests. The most basic aspect of the duty of loyalty is that the escrow agent must avoid self-dealing transactions, which places its interest in conflict with the obligations owed to its principals. For example, the escrow agent in *NRC, Inc. v.*

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17 *Durish v. Panan Internat’l N.V.*, 808 S.W.2d 175, 180 (Tex. App.—Houston [14th Dist.] 1991, no writ) (remitting award of damages to the amount improperly transferred from the escrow account).

18 778 S.W.2d 532 (Tex. App.—Corpus Christi 1989, writ denied).

19 *Id.* at 539.


22 *Id.; see also Bell v. Safeco Title Ins. Co.*, 830 S.W.2d 157, 161 (Tex. App.—Dallas 1992, writ denied); *Trevino v. Brookhill Capitol Res., Inc.*, 782 S.W.2d 279, 281 (Tex. App.—Houston [1st Dist.] 1990, writ denied); *Restatement (Second) of Agency*
Huddleston, was held to have breached its duty of loyalty when it concealed knowledge of the buyer’s earnest money check being drawn on a closed bank account and backed by insufficient funds, and the agent encouraged buyer to sue seller for specific performance in an attempt to retain escrow fees and secure a real estate commission.

4. Duties of Full Disclosure and Neutrality

Under the duty of full disclosure, the escrow agent must fully disclose to its principals all known material information affecting any interests of its principals. This duty to disclose does not arise absent actual knowledge of the information which the escrow agent is required to disclose. Therefore, an escrow agent is not obligated to investigate in order to obtain information affecting the interest of its principals.

The duty of full disclosure does not extend to the transaction as a whole, but is limited to his duties in the management of the earnest money. Based on this limitation, one court rejected a plaintiff’s claim that the escrow agent breached its fiduciary duty of disclosure by not disclosing an excepted title defect.

All of the foregoing duties can conflict with the duty that is unique to escrow agents versus other agents—the duty of neutrality. The essence of the escrow agent’s role in a transaction is his or her neutrality. As a neutral third party stakeholder, the escrow agent serves as the central depository for documents and funds being collected and disbursed in closing real estate transactions. Generally, escrow agents serve as disinterested third parties, thereby representing none of the parties to the transaction. Therefore, the escrow agent cannot perform duties for one party without the express consent of the other parties. As a practical matter, the escrow agent does not seek or obtain the express consent of the buyer in a residential real estate transaction to comply with the closing instruction letter from the lender. However, the lender is not a party to the transaction. Plus, the instructions are required for the lender to fund. Therefore, the buyer’s agreement to the instructions
can be implied from the circumstances, which include the buyer’s desire for the real estate closing to be funded.

Under this duty of neutrality, the escrow agent cannot place the interests of one party above the interests of another party to the escrow. Neutrality does not prevent an escrow agent from earning a fee for his work. However, neutrality may prevent the escrow agent from advising one party of the significance or consequence of an act or obligation of another party. Lenders often push the limit of neutrality by demanding action by the closer that could well negatively impact the borrower in the transaction. For example, lenders are fond of charging the closer with the obligation to advise the lender of “any facts that may impact the lender’s decision to close the loan.” Setting aside the nebulous nature of such a subjective requirement, the closer could be placed in a position of disclosing facts about the borrower that destroys the closer’s neutrality. For example, the lender may want to know that the borrower closed another residential property the day prior. Whether the closer can disclose this fact without jeopardizing neutrality is questionable. But when the loan blows up and the lender is looking for scapegoats, the closer who failed to disclose such information is a tempting target. And the closer’s subjective decision to not disclose such information is difficult to defend.

States have taken different approaches for dealing with the tension between the duty of disclosure and the duty of neutrality. Under the Restatement (Second) of Agency and in at least one state, an escrow holder’s duties are limited to the safekeeping of the escrow property and its delivery or return to the appropriate party, as the case may be, in accordance with the agreement; and, thus, entail no duty of disclosure whatever unless specified by the agreement. In at least two other states, an escrow agent has no duty to disclose unless it has actual knowledge of clear evidence of fraud. A further variation followed in at least two other states is that, although not required to investigate, an escrow agent has a duty to disclose facts that a reasonable escrow agent would perceive as evidence of fraud. Finally, at least two other jurisdictions prescribe that an escrow agent owes a duty to disclose all matters coming to the agent’s notice or knowledge concerning the subject of the agency that are material for the principal to know for his protection or guidance.

The issue is not yet settled in Texas. In City of Forth Worth v. Pippen, the Texas Supreme Court described the escrow agent’s duties as follows:

Rattikin took the City’s money to accomplish a purpose directed by the City. Rattikin was paid a fee for its services and for the careful handling of these funds. Rattikin therefore owed the City the duty of loyalty, the duty to make full disclosure, and the duty to exercise a high degree of care to conserve the money and pay it only to those

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36 439 S.W.2d 660, 664-65 (Tex. 1969).
persons entitled to receive it. Rattikin is liable for the breach of its fiduciary obligation, regardless of the fact that the City received exactly what it intended to buy.\textsuperscript{37}

Some courts have interpreted this language in \textit{Pippen} to mean that an escrow agent has the same duties of loyalty and full disclosure ascribed to general agent fiduciaries. But \textit{Pippen} only dealt with the alleged wrongful disbursement of funds, so arguably the court’s broad description of the duty was only meant to apply to the disbursement of funds and not meant to imply that these duties were coextensive with those held by general agents. Indeed, nothing in \textit{Pippen} suggests that the court considered the unique problem that the dual agency of escrow agents gives rise to potential conflicts that are incompatible with the broad fiduciary duties held by general agents. For example, is the escrow agent required to disclose material information obtained from one party when the disclosure of such information will be to the detriment of the party who disclosed it and requested that it be kept confidential? If the escrow agent does not disclose material information to the other party, the agent is essentially favoring one party over the other. But if the escrow agent does disclose the information, the agent is violating the duty of loyalty by disregarding the instructions of its principle that are within the scope of the escrow agency—the instructions to keep it confidential. In such a situation—and there are many other examples—the escrow agent is put in an untenable position that potentially results in a breach of fiduciary duty no matter how the agent decides to proceed.

The Houston Court of Appeals was confronted with this issue in \textit{Home Loan Corp. v. Texas American Title Co.}\textsuperscript{38} but declined the opportunity to address this conflict and provide escrow agents with clear guidance on how to address conflicting issues between the dual principals. In that case, the title company acted as the settlement agent in the closing of a residential mortgage loan made by Home Loan Corp. Home Loan then sold the loan on the secondary market but was obligated to repurchase it because no payments were ever made on the loan. Home Loan sued the title company alleging that it breached fiduciary duties by failing to inform Home Loan of various unusual or suspicious requests from the seller regarding the disbursement of the seller’s proceeds and failing to accurately disclose on the HUD-1 settlement statement how the proceeds would be or had been disbursed. The title company argued that its duties to Home Loan were “limited to: (1) carrying out the terms of the real estate contract and escrow agreement; and (2) disclosing any actual knowledge of a scheme to defraud Home Loan . . . .”\textsuperscript{39}

The court acknowledged that an escrow agent’s duties have been limited in various ways in the \textit{Restatement (Second) of Agency} and other states, but it declined to follow these approaches because it believed that doing so would be inconsistent with the Texas Supreme Court’s opinion in \textit{Pippen}.	extsuperscript{40} \textit{Home Loan} was appealed to the Texas Supreme Court but it denied the petition for review. It would not be surprising, however, if a court accepted an opportunity to address this conflict and the breadth of an escrow agent’s duties in the future. The title insurance is certainly hoping so.

One way to lessen the risk of this conflict is for the escrow agent to be transparent about how it intends to reconcile the duties of disclosure with the duties of neutrality. For example, the escrow agent could inform all parties that they should not consider information disclosed to them to be confidential with respect to the other parties to the transaction. By disclosing this, a party will

\textsuperscript{37} Id. at 665.

\textsuperscript{38} 191 S.W.3d 728 (Tex. App.—Houston [14th Dist.] 2006, pet. denied

\textsuperscript{39} Id. at 730.

\textsuperscript{40} Id. at 733-34.
understand it cannot disclose information to the escrow agent and expect that it be held confidential. By being transparent about the escrow agent’s intent, the escrow agent will have a strong argument that even if that action varied from its default duty of loyalty, the parties implicitly consented to the variation by going forward with the transaction.

Escrow agents often run into trouble with the duty of neutrality because of cozy relationships with developers, builders, or lenders. In that scenario, a closer may stop requiring adherence to the express terms of the closing instructions, or begin complying with oral instructions to preserve the business relationship. Deviation from the written understanding of the parties—especially the settlement statement or closing instruction letter—exposes the closer to liability if and when a problem develops. Given the escrow agent’s duties to all parties to the transaction, he must fully disclose to all parties any deviation from the written instructions.

5. The limits on an Escrow Agent’s Duties

An escrow agent does not have a duty to determine the correctness of a legal document provided to it. In *Holder-McDonald v. Chicago Title Insurance Co.*, the plaintiffs contended that attaching an incorrect legal description constituted a breach of fiduciary duty because it violated the mortgage loan closing instructions that defined the escrow agent’s obligations. The court characterized this argument as contending that “an escrow agent has an independent duty to determine the correctness of a legal description provided by a title company,” and the court declined to find such a duty existed. An escrow agent also does not have a duty to explain the risks or terms of a transaction.

B. Duties under the Texas Insurance Code and the Basic Manual

The State of Texas through the Department of Insurance strictly regulates those in the insurance industry, including the title insurance industry. Consequently, escrow officers are licensed in Texas and subject to established regulations and laws governing their business.

Escrow officers must be licensed in Texas. Escrow officers must pay a license fee and file an application, demonstrating qualifications for licensure. The department may investigate an applicant to ensure that all licensing requirements have been satisfied. A license may be denied or revoked if an individual has violated laws, misappropriated funds, engaged in fraudulent activities, or demonstrated dishonesty. Escrow officers must maintain a surety bond. In addition, escrow officers must complete continuing education.

42 Id. at 248.
43 See *IQ Holdings*, 451 S.W.3d at 872.
44 TEX. INS. CODE § 2652.001.
45 Id. § 2652.051.
46 Id. § 2652.053.
47 Id. § 2652.201.
48 Id. §§ 2652.001, 2652.101.
49 Id. § 2652.058.
Escrow officers must maintain records relating to escrow transactions.\(^{50}\) Escrow accounts are subject to an annual audit, a copy of which must be submitted to TDI.\(^{51}\) An escrow officer may not disburse funds from a trust fund account until good funds related to the transaction have been received.\(^{52}\) If an escrow officer is also a member of the State Bar of Texas, the disciplinary rules of procedure also apply with regard to management of escrow funds.\(^{53}\)

The Texas Title Insurance Act (located at Title 11 of the Texas Insurance Code) defines an “Escrow Officer” as an attorney, or bona fide employee of either (i) an attorney licensed as an Escrow Officer, (ii) a Direct Operation, or (iii) a Title Insurance Agent, whose duties include any or all of the following:

1. countersigning title insurance forms;
2. supervising the preparation and supervising the delivery of title insurance forms;
3. signing escrow checks; and/or
4. closing the transaction.\(^{54}\)

There is no specific duty for an escrow agent to “close a transaction” unless the title company is prepared to issue title policies contemplated by the underlying transaction.\(^{55}\) Once a title company elects to “close a transaction,” Texas law imposes certain statutory and regulatory duties under the Texas Insurance Code and various Procedural Rules adopted by the Texas Department of Insurance.\(^{56}\) Texas requires title companies to only close transactions through escrow officers who are educated, licensed and bonded as provided in Chapter 2652 of the Texas Insurance Code.\(^{57}\) In closing a transaction, the escrow agent has a duty to determine that all necessary papers have been filed of record.\(^{58}\)

**C. Duties Arising from Contract**

Under an escrow agreement, a party deposits funds, property or written documents with a neutral third party (the escrow agent) to be delivered upon performance of the identified conditions or the happening of specified events.\(^{59}\) Generally, a written agreement is necessary to create an escrow, though it may be implied from the conduct of the parties. The standard TREC Residential Real Estate Contract includes a brief escrow agreement for delivery of earnest money to the escrow agent at the

\(^{50}\) Texas Title Ins. Basic Manual, Sec. IV, P-32 (hereafter, “Basic Manual”).

\(^{51}\) TEX. INS. CODE § 2652.005; Basic Manual Sec. IV, P-49.

\(^{52}\) TEX. INS. CODE § 2652.004; see also Basic Manual, Sec. IV, P-27.


\(^{54}\) Id. § 2652.201.

\(^{55}\) See Boenker v. American Title Co., 590 S.W.2d 777, 779 (Tex. Civ. App.—Houston [14th Dist.] 1979, no writ) (title insurance company has no obligation to “close a transaction” if it is not prepared to issue the title policy contemplated by the transaction).

\(^{56}\) See, e.g., Tamburine v. Center Sav. Ass’n, 583 S.W.2d 942, 949 (Tex. Civ. App.—Tyler 1979, writ ref’d n.r.e.) (in its capacity as an escrow agent, a title insurance company will close the transaction for which title insurance is obtained).

\(^{57}\) See Basic Manual, § IV., P-1(s).

\(^{58}\) Tex. Ins. Code § 2501.006(b)(6).

selected title company. The contract further describes certain actions by the title agent for issuance of the commitment for the title insurance policy. But the contract does not set forth the entire agreement of the parties with regard to the title agent’s role as escrow officer. That role is defined by Texas statutory law governing the escrow officer’s duties in closing the transaction, common law as well as the closing instructions provided by the lender that funds the transaction. Separate escrow agreements are rarely executed by parties to residential real estate transactions.

For an escrow agreement to be binding, the parties must agree on the terms for the escrow agent to retain the deposited funds or property and terms regarding the disbursement or delivery of such deposited items. The escrow agreement must be clear and definite. The best practice is to use written escrow agreements containing a specific set of instructions that define the escrow agent’s duties, signed by the escrow agent and the parties to the underlying contract. If doubt exists over the creation of an escrow relationship, Texas courts will consider the terms of the underlying agreement, delivery of instruments, funds or property to a third party, and the circumstances surrounding execution of the underlying contract. The escrow agent’s responsibilities are limited to the scope of the express escrow agreement.

III. ESCROW CLAIMS

A. Failure to Discharge Obligations Under Escrow Agreement

The most common claims for failure to comply with the escrow agreement involve problems with disbursal of settlement funds. The closer may fail to pay prior tax obligations because he was unaware of a second tax account linked to the subject property. Closers may also rely on incorrect or false information about the prior discharge of other liens, and instead disburse the funds to the seller. Closers may pay off a loan not secured by the insured property, confusing it with a loan on a different tract.

Errors are not limited to disbursal of settlement proceeds. Closers may fail to obtain executed instruments before releasing the funds. Additionally, closers occasionally retain title instruments in the closing file rather than recording them. In short, closers make errors at every stage in the closing and those errors sometimes result in claims that require resolution.

When a title agent or title underwriter must pay the rightful owner of such funds for inadvertently disbursed settlement proceeds, or otherwise discharge liens to clear title, the payor may seek recoupment from the party that received the inadvertent disbursement. The doctrine of equitable subrogation provides a legal basis for recoupment of such payments.

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60 See Chapman Children’s Trust v. Porter & Hedges, L.L.P., 32 S.W.3d 429, 438 (Tex. App.—Houston [14th Dist.] 2000, pet. denied) (escrow agent is generally appointed through contract describing escrow agent’s legal obligations); see also Starkey v. Tex. Farm Mortgage Co., 45 S.W.2d 999, 1000 (Tex. Civ. App.—Waco 1932, writ ref’d) (parties must agree the underlying contract is delivered to neutral to be held and delivered subject to specified conditions).


B. Disputes Over the Escrow Funds and Interpleader

When the parties act in accordance with their agreement, the escrow agent is merely an intermediary in the deal. However, problems will arise when the parties do not perform as planned and agreed. For example, a buyer may decide to not buy a property even after a contract has been executed and earnest money has been delivered. The buyer will attempt to pigeon-hole the facts into a scenario which results in return of the earnest money. Meanwhile, the seller will be eager to receive the earnest money for the failed sale. Invariably, the closer will receive competing demands for the earnest money, thus setting up the classic interpleader scenario.

To prevent multiple lawsuits and liability, the escrow agent can file an interpleader action under Texas Rule of Civil Procedure 43. Under Rule 43, a party who receives multiple claims to funds in its possession may join all claimants in one lawsuit and tender the disputed funds into the registry of the court. A party faced with competing claims obtains a discharge of liability to the competing claimants by interpleading the funds. A party is entitled to interpleader relief if the following three elements are met: (1) it is either subject to, or has reasonable grounds to anticipate, rival claims to the same funds; (2) it has not unreasonably delayed filing its action for interpleader; and (3) it has unconditionally tendered the fund into the registry of the court. Failure to satisfy any of these elements will defeat a petitioner's standing as an innocent stakeholder and preclude interpleader relief.

Essentially, an interpleader action offers the escrow agent a procedural device to resolve multiple liability as an innocent and neutral stakeholder. Once the escrow funds are placed into the court's custody, the escrow agent is dismissed as a party to the interpleader and the defending parties must litigate their disputed rights to the funds among themselves. If the disputed funds are not actually paid into the Court’s registry, the funds must at least be tendered and the tender must be unconditional in order to be valid.

The escrow agent (as an innocent stakeholder) is entitled to recover its attorney fees from the deposited funds if he has a reasonable doubt about which claimant is entitled to such funds. The innocent stakeholder must prove the reasonableness of the fees sought. The award of attorney fees is within the sound discretion of the trial court.

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65 TEX. R. CIV. P. 43; See also Cable Communications Network, Inc. v. Astina Cat. & Sur. Co., 838 S.W.2d 947, 950 (Tex. App.—Houston [14th Dist.] 1992, no pet.).
68 Texas Workforce Comm'n v. Gill, 964 S.W.2d 308, 310 (Tex. App.—Corpus Christi 1998, no pet.).
69 See Security Nat'l Bank of Lubbock v. Washington Loan & Fin. Corp., 570 S.W.2d 40, 43 (Tex. Civ. App.—Dallas 1978, writ dism’d) (interpleader's unconditional offer to deposit the funds with the Court is enough to satisfy the unconditional tender requirement of interpleader action); Cockerum v. Cal-Zona Corp., 373 S.W.2d 572, 574 (Tex. Civ. App.—Dallas 1963, no writ) (only an unconditional tender of the funds is required, actual deposit of the funds is not).
71 Foreman v. Graham, 693 S.W.2d 774, 778 (Tex. App.—Fort Worth 1985, writ ref’d n.r.e.).
C. Defalcation/Fraud

Escrow theft occurs when a settlement agent converts funds deposited for a real estate transaction, rather than disbursing the funds properly. An egregious example of this type of theft would be conversion of settlement proceeds. Funds destined for disbursement to the seller are rarely stolen since the buyer will swiftly know the funds have not been disbursed. Instead, dishonest closers will advise all parties a prior lien has been paid off when in fact the funds have been converted. The agent will often conceal the fraud by making payments to the previous lender to keep the loan current. Eventually, the closer stops paying the loan, which goes into default and the subsequent foreclosure brings the fraud into full view. Usually, by the time the closer has absconded with the funds.

Generally, title insurers are not liable for fraud or theft by an independent title agent. Title agents are considered agents of the insurer only insofar as the issuance of the title insurance policy is concerned. Of course, this would not hold true for a direct operation. When the title underwriter owns the title agency, it would have liability for any fraud or theft by the agent.

Closers will also engage in conversion of title insurance premium, which must be delivered to the title insurer in accordance with statutory law and the agency contract. When operating money runs short, an agent may use the premium to make payroll or pay the rent. Whatever the purpose, use of premium is unlawful. The agent collects the premium for the title policy as a fiduciary for the insurer. Use of the premium constitutes conversion. Moreover, if the agent is also a lawyer, improper use of premium constitutes a violation of ethics rules.

D. Insured Closing Protection Letter (CPL)

Lenders can obtain protection for agent defalcation through receipt of closing protection letters for transactions they fund. Closing protection letters (“CPLs”) specifically apply to escrow closing activities and services performed for underwriters of title by approved attorneys or agents who are not employees of the title companies. The standard from CPL is promulgated by the Texas Department of Insurance to provide indemnity to lenders for certain events in connection with closing the real estate transaction. The letters provide specific conditions or contingencies under which title insurers must accept liability for the acts or omissions of the agents. CPLs are intended to indemnify lenders against losses incurred as the result of (1) dishonesty or fraud by an issuing agent or approved attorney in handling the lender’s funds or documents in connection with the specific transaction for which the letter is issued, and (2) issuing agent’s or approved attorney’s failure to comply with the written closing instructions of the lender that relate to status of title, the validity, priority or enforceability of the mortgage on the land, including the obtaining of documents and disbursement of funds in connection with the transaction. When a lender purchases a loan policy of title insurance in connection with a transaction, the title underwriter must issue a CPL without charge to the lender, upon request. Most lenders request CPLs as a matter of course in their closing instruction letter.

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73 See Cameron County Sav. Ass’n v. Stewart Title Guar. Co., 819 S.W.2d 600 (Tex. 1991) (no actual or apparent agency relationship existed because title insurer made no promise to cover losses incurred as the result of actions of party closing the loan).

74 See Tex. Ins. Code § 2651.013 (all premium remittances owed to title underwriter “are considered to be held in trust for title insurance company”); See also Rate Rule R-2 (requiring title agents to send premium remittances to underwriter “no later than 15th day of the second month following month in which the premium is collected”).

75 Standard form CPL is contained within the Basic Manual.
In *American Title Insurance Company Variable Annuity Life Insurance Co.*, the Fourteenth Court of Appeals addressed the scope and extent of coverage provided under American Title’s closing protection letter. In that case, a mortgage lender tendered funds to a title insurance company for a refinance loan. The closing agent failed to provide good funds to the original lender (check was returned ISF) to pay off the existing loan. The agent subsequently went into receivership. American Title had issued a CPL to the refinancing lender. When the lender made demand under the CPL, American Title issued payment to the prior lender an amount equal to the limits of its title insurance policy, contending that the policy limited its liability in the transaction. To avoid foreclosure on the subject property by the prior lender, the refinancing lender was forced to pay the balance of principal, interest, and attorney’s fees due on the prior loan.

In holding American Title liable to the lender for the full payoff of the prior loan, the court held the title company’s payment had only satisfied the title company’s obligation under the title insurance policy. Such payment, however, failed to satisfy the title company’s obligation under the CPL. Under the CPL, the title company guaranteed the replacement of any lost settlement funds due to an agent’s fraud or dishonesty. As such, the refinancing lender was entitled to recover under the CPL for the agent’s “misappropriation or loss of settlement funds.” The court therefore ordered the title company to pay the entire amount necessary to discharge the prior loan in full. The court held the title company had waived its right to approve or consent to the settlement reached between the prior lender and the refinancing lender, irrespective of the protective language in the CPL for “matters created, suffered, assumed or agreed to” by the lender, because the title company had “consistently denied liability” under the insured CPL. The court also ordered the title company to pay the refinancing lender its reasonable and necessary attorney’s fees, because the title company “is liable, on its own behalf, for breach of the insured closing letter.”

**IV. CONCLUSION**

Closing real estate transactions is fraught with peril. Escrow agents must balance the interest of the parties to the transaction while satisfying the demands of persnickety lenders. Increased federal regulation and oversight enhances the opportunity for liability in connection with real estate closings. Further, escrow agents often become the target of claims when real estate transactions fail. In short, there are myriad opportunities for the escrow agent to be exposed to liability. This paper is intended to create awareness in escrow agents of potential sources of liability so as to avoid problems in the future.

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77 Id. at *12.

78 Id. at *15.