



HARD ECONOMIC TIMES MEAN A SURGE IN REAL ESTATE MALPRACTICE CLAIMS

Real estate malpractice claims are historically second only to personal injury-plaintiff claims in terms of frequency. This high frequency is attributable more to the large number of lawyers that practice real estate law than to any lack of competence in that part of the bar. Real estate malpractice, however, more than other areas of law involves substantive errors. They center on title searches, document preparation, and failure to know the law.

REAL ESTATE MALPRACTICE ERRORS

- Erroneous description in deed of property to be conveyed
- Misstated date to which interest was to be computed
- Failure to fill in blank on form
- Failure to reserve mineral rights
- Failure to advise on impending change in law
- Unauthorized delay or failure to strictly enforce closing time limits
- Failure to discover encumbrances on the property:
 - mortgage lien or deed of trust
 - tax lien
 - mechanic's lien
 - right-of-way
 - mineral lease
- Failure to attend commissioner's sale
- Failure to know other applicable law, e.g., probate, tax
- Failure to assure that clients received or conveyed title as represented:
 - remainder
 - dower
 - outstanding life estate
 - lease
- Errors in the description of the property
- Failure to perfect security interest:
 - failure to prepare mortgage document
 - failure to update title search at time of closing
 - failure to record or timely record a mortgage
 - filing in the wrong county
 - failure to obtain releases of other encumbrances
- Failure to collect or protect security interest

A recent ABA study showed that nation-wide for the period 1996-99 real estate malpractice claims accounted for nearly 17% of all claims. As the box showing Lawyers Mutual's real estate malpractice history reveals, we in Kentucky have apparently surged ahead of the 1999 national average in the last two years.

A Malpractice Trend Going The Wrong Way

| Lawyers Mutual | Total Reports | Real Estate Reports | Real Estate % |
|------------------|---------------|---------------------|---------------|
| 1988 | 17 | 6 | 35% |
| 1989 | 26 | 7 | 27% |
| 1990 | 65 | 11 | 17% |
| 1991 | 55 | 11 | 20% |
| 1992 | 80 | 16 | 20% |
| 1993 | 110 | 14 | 13% |
| 1994 | 120 | 24 | 20% |
| 1995 | 140 | 17 | 12% |
| 1996 | 141 | 21 | 15% |
| 1997 | 130 | 24 | 18% |
| 1998 | 144 | 21 | 15% |
| 1999 | 168 | 26 | 15% |
| 2000 | 165 | 33 | 20% |
| 2001-Oct. | 125 | 30 | 24% |
| Total | 1486 | 261 | 18% |

It is always difficult to pinpoint reasons for increases in a type of malpractice claim, but there is a clear correlation between economic downturns and real estate claims. Businesses go bankrupt and buyers of real estate default on mortgage payments. Tax and mechanic's liens are recorded in increasing numbers. The result is that undetected errors in real estate transactions begin to surface. Usually at this juncture everyone is insolvent and uninsured except for the lawyers who become the deep pockets in the equation. What follows is an outline of risk management principles for real estate practitioners. This is a review for most, but now is the time to be especially cognizant of real estate malpractice risks.

KNOW WHO YOUR CLIENT IS

Since real estate transactions involve many individuals and entities, it is essential that the lawyer clearly identify with the client represented and that all other parties are on notice that they are not the lawyer's client. If this is not implicit from the circumstances, make it explicit. Client identification confusion often arises when:

- Working through a broker.
- Representing the mortgagee as the only lawyer at a closing.
- Working through a representative of a business group client.
- Real estate transactions involving family, elderly, and divorce.

DOCUMENT THE SCOPE OF THE ENGAGEMENT

Always use a letter of engagement to document the work to be done. The majority of real estate malpractice claims concern title searches. Is the lawyer to prepare an abstract of title indicating only what land records contain or a title opinion on validity of ownership? Is the search for liens only? Is the lawyer responsible for accuracy through the date and time of the completion of the title search or required to bring the search current to the time of closing? Be precise, detailed, and exclusive in the scope description.

REDUCE REAL ESTATE MALPRACTICE EXPOSURE BY:

- Understanding nonclient liability in real estate transactions. The rule for Kentucky lawyers is *Seigle v. Jasper*, Ky. App., 867 S.W.2d 476, 482 (1993): "Where the abstractor knows, or should know, that his customer wants the abstract for the use of a prospective purchaser, and the prospect purchases the land relying on the abstract, the abstractor's duty of care runs, as we have said, not only to his customer but to the purchaser. Moreover, others involved in the transaction through their relationship to the purchaser - such as lender mortgagees, tenants and title insurers - will also be protected where the purchaser's reliance was known or should have been known to the abstractor. But a party into whose hands the abstract falls in connection with a subsequent transaction in not among those to whom the abstractor owes a duty of care."

- Understanding the difference between escrow agent and client trust account management. An escrow agent is a neutral party with fiduciary obligations to all involved in the escrow arrangement. A lawyer holding the proceeds of a real estate transaction in a client trust account represents the client and has third party responsibilities for others with a claim on the proceeds. Read Kentucky Rule of Professional Conduct 1.15 Safekeeping Property. Never, never disburse the proceeds of a real estate sale until the title search is updated, the transaction documents recorded, and all checks providing funds for disbursement cleared.

MANAGE TITLE SEARCH ABSTRACTS AND OPINIONS CAREFULLY

1. Specify in the abstract or opinion the scope of the search, its purpose, authorized uses, and restrictions.

2. If others are preparing evaluations on some parts of the transaction, clearly exclude those parts. If there is reliance on an expert opinion as part of the analysis (e.g., an environmental assessment), show that in detail.
3. Be complete. Advise of any doubts or potential title defects no matter how remote. Taking risks on defects is the client's decision - not the lawyer's.
4. Establish office procedures for quality control of title search documents. Procedures should indicate who is authorized to sign and release them for the firm and provide for a formal and cold review before release.

USE REAL PROPERTY TRANSACTION CHECKLISTS

A good checklist for sale of real estate should cover in detail at a minimum: 1) the parties; 2) description of property; 3) condition of title; 4) construction status; 5) purchase and loan terms; 6) warranties of seller; 7) conditions of buyers obligation; 8) escrow; and 9) closing.

TEN COMMANDMENTS OF REAL ESTATE CLOSINGS

By Wayne Stephenson, *Lawyers Mutual Liability Insurance Company of North Carolina*
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1. Thou shalt not walk into the deed vault nor close a real estate transaction unless thou knowest what thou art doing or thou has a learned brethren or sistren to lend a helping hand. The days when " anyone can close a loan" are gone.
2. Thou art not a title insurance company nor is thy malpractice carrier. Many are those, both owners and lenders, who are using their attorney as their title insurance company.
3. Thou shalt document the substance of every telephone conversation involved in the transaction. Thou shalt cover thine hind parts.
4. Thou shalt have a working knowledge of

environmental law. And lo, there shall one day be pestilence upon the entire face of the earth and environmental law will touch every transaction.

5. Verily, verily I say unto you that the closing attorney is as the hub of a wheel and each party to the transaction a spoke. If in the future any of the spokes is broken economically, ye whose name was blessed at closing shall be called "Oh cursed one." Beware of the potential conflict of interest that could be alleged in the future and proceed cautiously.
6. Thou shalt not disburse loan proceeds before updating and recording title. "Tis better to suffer the wrath of an angry realtor or property owner than to bury thy law license in the sand."
7. Thou shalt uncover thine eyes and proofread carefully the work of those thou superviseth. If thy support staff has erred

and thou has not reviewed their work, then two errors have occurred. Many is the attorney who has suffered a claim because of a typo the size of a mustard seed.

8. Thou shalt say "Get thee behind me Satan" if thou art pressured to perform a transaction in a way that thou thinks is improper. Do not succumb to the almighty dollar. Tis better to lose a closing fee than to suffer the slings of multiple claims resulting from a system breakdown because one has worshipped at the altar of the "Cash Cow" client.
9. Thou shalt always review each instrument within the title search in its entirety. Beware the deed of trust that encumbers the property in the hidden "Attached Schedule A."
10. Thou shalt never forget this real estate transaction is the biggest transaction of thy client's life. Communicate, communicate, communicate.

For more information about Lawyers Mutual, call (502) 568-6100 or KY wats 1-800-800-6101 or visit our web site at www.lmick.com



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Malpractice Avoidance Update

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