MEMORANDUM

TO: LTAC/RE 8706-007

FROM: Seymour Joseph

RE: Analysis of Provision 12.a of Standard Form Commission Contract

DATE: August 5, 2003

Background

Conway-Bogue Realty Investment Co. v. Denver Bar Association, 135 Colo. 398, 312 P.2d 998 (1957) and The Title Guaranty Co. v. Denver Bar Association, 135 Colo. 423, 312 P.2d 1011 (1957), addressed the practice of law by brokers and title companies in real estate transactions. Preparing contracts, deeds and other documents by filling in blanks of standard real estate forms for a simple transaction **is** the practice of law. The Title Guaranty case held it was the unauthorized practice of law for title companies. In contrast, the Supreme Court did not prohibit brokers from engaging in a limited practice of law: They can select, fill in, explain and advise regarding the legal effect of standard simple real estate forms "at the request of their customers." Conway-Bogue, supra at 1006. The Supreme Court's opinions stress the practice of law by a broker in a "simple" transaction. The parties and/or their brokers need to realize that when an agreement may be complicated, an attorney should be consulted rather than a broker's using a standard form. Id. at 1010.

The legislature has provided that brokers may use standard real estate forms. C.R.S., §12-61-803(4). The real estate commission (the "Commission") has jurisdiction over brokers, and Rule F mandates the use of commission approved standard forms. Real Estate Manual at 25-1. The Supreme Court has plenary authority regarding the practice of law. The standard forms adopted by the Commission, therefore, must comply with Conway-Bogue and Title Guaranty's restrictions on the practice of law by brokers and title companies. The Commission has recognized that limitation, and its standard forms are intended to keep broker practice in compliance with Conway-Bogue. Manual at 5-3, 25-1. If other than a standard form is used, it must be prepared by the parties or an attorney. Id. at 25-1, 25-5 (addendum).

The Commission has no jurisdiction over title companies, which are regulated by the Division of Insurance. Because of the close working relationship between the title insurance and real estate industries, the Commission tries to coordinate the workings of both. Manual at 9-3. When its standard forms implicate title companies, the Commission should try to accommodate title company concerns.

There is no question that the preparation of a deed involves the practice of law. A broker does not have to prepare any legal document. Manual Rule E 37 at 2-31. Under Title Guaranty, a title insurance company is not allowed to prepare legal documents on its own. They do so on the understanding that the title company acts as a scrivener/agent in preparing legal documents for the broker. Manual, CP-7 at 3-8. This scrivener relationship is documented in the Commission's standard Closing Instructions. Paragraph 2 of the Closing Instructions requires the title company to close a transaction in accordance with the terms of the contract, but

specifically excludes from the title company's responsibility, the preparation of legal documents. The bottom of the Closing Instructions, however, provides for the title company to complete documents, such as a deed, subject to broker review and approval, with the broker being responsible for the accuracy of the document.

Just as a broker does not have to prepare legal documents, neither does a title company, and it need not sign the bottom of the Closing Instructions. If a broker should not prepare a document because it would constitute the unauthorized practice of law, a title company should not prepare that document as an agent/scrivener of the broker.

Closing services performed by a title company are different than its title insurance services. Different people are employed for each service. With regard to the title insurance, the title company employees owe their duty of loyalty to the title company, and they do not act as an agent for either of the parties. Title Guaranty at 1016-1017. Manual at 5-4. See Montano v. Land Title Guaranty Co., 778 P.2d 328, 331 (Colo. App. 1989) (title company employee not agent of attorney for party because subject to control of her employer title company). But see Franklin Bank v. Bowling, 2003 Colo. Lexis 555 (6/23/03) (dicta re: title company agent of purchasers). With regard to closing services, the title insurance company is a limited agent for both parties to the contract and cannot act adversely to one for the benefit of the other. See Burman v. Richmond Homes, Ltd., 821 P.2d 913, 920 (Colo. App. 1991); White v. Brock, 41 Colo. App. 156, 584 P.2d 1224, 1228 (1978).

Provision 12.a in the Commission's standard form contract dictates that title is to be conveyed subject to those exceptions accepted by the buyer. The Commission is proposing to

modify Provision 12.a to mandate that the specific list of exceptions contained in the title commitment be attached to the deed. The title company is not a party to the contract, but Provision 12.a may dictate how the title company should prepare the deed if the title company agrees to be the scrivener in accordance with the standard Closing Instructions. Provision 12.a, in both its present and proposed form violates the unauthorized practice of law limitations in Conway-Bogue.

Provision 12.a's Favoring The Buyer's Legal Interest At The Expense Of The Seller Creates Unauthorized Practice Of Law Issues.

At present, there is no Commission standard form warranty deed. Brokers are told to use their best judgment. Manual at 5-3. One of the problems with Provision 12.a is that it does not allow for judgment by the broker. It provides that title shall be conveyed subject to:

> a. Those specific Exceptions described by reference to recorded documents as reflected in the Title Documents accepted by Buyer in accordance with §8a [Title Review]....

This provision creates legal rights favoring a buyer at the expense of the seller, without affording the broker judgment in helping the parties resolve their conflicting interests.

A seller's interests are favored by broad language for deed warranty exceptions, such as "easements, restrictions, reservations, covenants, and rights of way record." 2 Krendl Colorado Methods of Practice §64.30 at 263 (1998). In contrast, it is in the buyer's best interest to have a narrower list of specific exceptions. Id. Although there is no standard form deed, itself, Provision 12.a provides for preparation of a deed with specific warranty exceptions, which creates legal rights favoring the interest of buyers at the expense of sellers.

While Provision 12.a of the standard form contract provides for specific exceptions, the Manual recognizes that deed warranties may be limited by broad general language such as "subject to all encumbrances and restrictions of record." Manual at 8-6. In fact, the Commission's standard form deed of trust uses broad warranty exception language: "subject to general real estate taxes for the current year, easements of record or in existence, and recorded declarations, restrictions, reservations and covenants, if any, as of this date...." Id. at 25-124. The warranty exception language in a FNMA standard form deed of trust is even broader: "subject to any encumbrances of record."

It is the position of LTAC that the Commission's standard form contract should leave a blank (or list alternatives) with regard to how a deed's warranty exceptions should be prepared, and brokers should work with both buyers and sellers to resolve the issue. This is similar to what the Commission has done with paragraph 12 of the current contract form with regard to leaving blank whether title will be conveyed by a general warranty, special warranty, or even quitclaim deed. There can be a significant difference in warranty liability with regard to a general and a special warranty deed. The Commission's standard form leaves that decision to be made by the parties with the help of a broker(s). The same approach should be followed with regard to whether a deed contains specific exceptions, a broad general exception, or a combination of both.

If anything, broad warranty exception language gives the transaction more of a semblance of balance. It gives sellers more warranty protection than by using the specific exceptions in Provision 12.a, and buyers would have their title insurance protection.

The Supreme Court has authorized brokers to engage in the limited practice of law "at the request of their customers." Conway-Bogue, supra at 1006. The Court specifically referred to seller-broker and buyer-broker relationships. Id. Until 1993, the relationship of a broker and his/her customer was an agency one, with fiduciary duties owed by the broker. See Moore & Co. v. T-A-L-L, Inc. 792 P.2d 794, 798-99 (Colo. 1990). The Supreme Court did not prohibit brokers from engaging in the limited practice of law in the context of allowing the public to "choose whether **their** broker **or their** lawyer shall do the acts or render the [real estate] service...." Conway-Bogue, supra at 1007. The services that brokers asked to perform, and that the Supreme Court authorized, were more than just filling out a standard form. It included explaining and advising customers as to the legal effect of such forms. Id. at 1004-1006. Implicit, if not explicit, in the Supreme Court's holding in Conway-Bogue is that when brokers practice law, just as attorneys, they owe their clients/customers a duty to act in their best interest.[1]

Since 1993, however, brokers are presumed to be nonagent transaction-brokers, who owe no fiduciary duties. Hoff & Leigh, Inc. v. Byler, 62 P.3d 1077, 1078-79 (Colo. App. 2002). The transaction-broker is not an "advocate for the interest of any party to [the] transaction", but is rather an "intermediary." Sussman v. Stoner, 143 F. Supp 2d 1232, 1238-39 (D. Colo. 2001). See C.R.S., §12-61-801(6), -807(1). If the standard form contract left blank the warranty exceptions provision, a transaction-broker might be able to explain and discuss alternatives with both buyer and seller. Since Provision 12.a contains standard form language favoring the buyer

[1]In contrast, title company employees owe their duty of loyalty to the title company, and not to either the buyer or seller. Title Guaranty, supra at 1016, 1017.

by using specific exceptions, the transaction-broker cannot advise the parties one way or another without being an advocate.

The use of Provision 12.a in a standard form is misleading to the public. Although there is no empirical evidence, it is reasonable to presume that the public believes that a standard commission approved form will be more or less neutral with regard to the legal rights of buyers and sellers, and that brokers will provide explanations if it is not. Provision 12.a favors buyers and is not neutral. Provision 8.f of the contract advises buyers to consult legal counsel with regard to title matters, but there is no similar advisory to sellers with regard to warranty obligations.

A "buyer's-agent" might comment favorably to his client regarding Provision 12.a. A "sellers-agent" might be negligent to allow the provision to remain in the contract without challenging it. If the standard form contract had to be revised to remove or modify Provision 12.a, the parties and/or their broker(s) may have to hire lawyers to do so. See Conway-Bogue at supra 1010. The real estate manual calls for the parties or attorneys to prepare legal documents other than standard form documents. Manual at 25-1, 25-5.

When a transaction-broker uses a standard form contract and authorizes the preparation of a deed pursuant to Provision 12.a, that broker is practicing law. Although statute provides, and the public believes, that the transaction-broker will be neutral with regard to the parties, the broker is practicing law in favor of the buyer when a standard form contract containing Provision 12.a is used. **There is a question whether a transaction-broker is authorized to practice law at all under Conway-Bogue since they are not agents and do not owe fiduciary duties to act**

in the best interest of either party. Provision 12.a should be deleted or modified so that the standard form contract takes as neutral a position as possible with regard to deed warranty exceptions.

Conway-Bogue authorized brokers to practice law by using simple standard forms. Accommodating conflicting interest of buyers and sellers with regard to deed warranties is not a simple matter. It has been made even more complicated by the presumed transaction-broker nonagent relationship created by the legislature. When brokers use a standard form contract, with Provision 12.a creating legal warranty rights that favor buyers at the expense of sellers, they are not engaged in the practice of law authorized by Conway-Bogue. They are engaged in the unauthorized practice of law. When preparing such deeds constitute the unauthorized practice of law by brokers, title companies should not participate in that unauthorized practice by preparing such deeds on behalf of brokers.

Provision 12.a Requires Title Companies To Confirm With Buyer And Seller Which Exceptions Have Been Accepted By The Buyer Pursuant To §8a.

Provision 12.a provides for title to be conveyed subject to specific exceptions "accepted by Buyer in accordance with §8a." How does a title company know which exceptions have been accepted by the buyer? The title company may need the Closing Instructions modified to provide for estoppels by the both the buyer and the seller, confirming that specified exceptions have been accepted by the buyer pursuant to the contract.

Provision 12.a Has The Potential To Create Substantial Marketable Title Problems.

C.R.S., §38-35-108 provides that references under a recorded document to other recorded documents constitutes notice of those other documents. When a list of specific exceptions are

attached to a deed pursuant to the proposed revised Provision 12.a, the public will be deemed to have constructive notice, not only of the recorded deed, but of every recorded instrument listed in the exceptions. This will increase exponentially the clouds on title to property by vastly multiplying the title record. With more documents to examine, there are more chances for ambiguities and mistakes to occur with regard to title. For example, a restriction or encumbrance may be released, but out of an overabundance of caution, it may still be listed by a title company as an exception in a subsequent deed, and, thus, continue to encumber title.

Public policy in Colorado is to render titles more marketable. C.R.S., §38-34-101. Provision 12.a and its proposed revision run counter to that policy by providing for a standard form deed that will be recorded with a list of specific warranty exceptions attached. Each exception will duplicate or create a cloud on title. Although Provision 12.a is bad enough, attaching a list of specific exceptions to the deed would be even worse. It would add multiple clouds on title. Since deed warranties run with the land, the list of specific exceptions would continue to run down the chain of title to remote grantors. See C.R.S., §38-30-121.

Use Of A Title Commitment To Determine A Seller's Warranty Obligation Raises Additional Legal Issues That Should Not Be Addressed By Provision 12.a's Form Language.

As addressed above, deed warranty liability is a complicated issue, and by resolving that issue in favor of buyers, Provision 12.a promotes the unauthorized practice of law by brokers. Using the exceptions in a title insurance commitment as the standard measure of a seller's warranty liability, complicates the issue even further, providing additional reasons for deleting Provision 12.a.

The parties, with or without the advice of brokers and/or attorneys, can **choose** to use title commitment exceptions to determine a seller's deed warranty exceptions. Provision 12.a, however, abdicates the responsibility of brokers and the parties to reach an agreement on that issue by making the choice for the parties. Broad warranty exception language is not a choice in the standard form contract. Provision 12.a resolves the issue by having the parties rely on the title company's judgment as to appropriate exceptions **for the purposes of its title commitment** to be the measure of a seller's warranty liability. There are several problems with this use of the title company's commitment.

First, Provision 12.a shifts the responsibility for deed preparation from the broker, who can practice law, to the title company who cannot. The title company's role in deed preparation is supposed to be limited to that of a mere scrivener. The title commitment is a separate contract between the title company and its insured, and it is a separate function from the closing services provided by a title company as a scrivener. In preparing its commitment, the title company is not an agent of either the buyer or seller, and it cannot practice law by advising either party as to what language should be used to address a seller's deed warranty liability. That decision is supposed to be based on the legal judgment of the parties, their brokers and attorneys. Provision 12.a, however, tries to impose that responsibility on the title company, who cannot practice law.

Second, it is not appropriate to have a standard form contract determining a seller's warranty liability based on title commitment exceptions because the commitment is not prepared for that purpose. Provision 12.a disregards the limitations of a title commitment as a representation of the status and title to property. Paragraph 7.a of the Contract give the parties a

choice of using an abstract or a title commitment as evidence of title. There are significant legal difference between the documents.

An abstract is a representation and warranty as to the state of title. Manual at 9-2. It is supposed to contain all impairments of record, and there may be negligence liability if any are omitted and title is not accurately reported. Id. at 9-1, 9-2. That liability may extend to both buyer and seller. Parties will generally want an attorney's title opinion to interpret the abstract as to the current state of title. The cost associated with an abstract generally far exceeds the cost of title insurance.

In contrast, a title commitment is a contract of insurance, in which the title company states the conditions under which it will issue its insurance policy. Arapahoe Land Title, Inc. v. Contract Financing, Inc., 28 Colo. App. 393, 472 P.2d 754, 756-57 (1970). The commitment shows what insurance the title company is willing to sell and under what circumstances. Manual at 9-3. A title commitment is a contract for insurance and is not intended as a guaranty or representation as to the complete state of title. See First Federal Sav. & Loan v. Transamerica Title, 793 F. Supp 265, 270 (D. Colo. 1992), aff'd, 19 F.3d 528 (10th Cir. 1994). Because title company liability under insurance commitments are contractual, they are better able to manage underwriting risks and keep rates lower.

Unlike an abstract, a title commitment need not list all impairments of record. See C.R.S., §10-11-106(2).A title company is only obligated to conduct a reasonable examination of title and **determine insurability** in accordance with sound underwriting practices. Id., §10-11-106(1). The listing of exceptions in a title insurance commitment involve judgment and

discretion by the title company. Different title companies may evaluate underwriting risks differently and list different exceptions on title commitments for the same property. The listing of exceptions in a title insurance commitment may also be subject to negotiation by buyer or seller. "Both standard and non-standard exceptions may sometimes be deleted or insured against if specifically requested." Manual at 9-2. See Provision 7a of Standard Form Contract.

Significantly, the Schedule B-2 exceptions in the title commitment are prepared for the benefit of the title company. They specify what the title company will not insure. The title company and the buyer, as proposed insured, are the parties to the title commitment. The title company does not prepare its commitment as an agent for buyer or seller to determine warranty liability, or for any other reason. Under the title insurance commitment, the title company may have contractual liability to the insured buyer, but there is no liability to the seller. Jimerson v. First American Title Ins. Co., 989 P.2d 258 (Colo. App. 1999).

Under the standard form contract, a buyer can choose to accept or reject title based on: 1) the representation and opinion of title associated with an abstract; or 2) the title which the title insurance company is willing to insure under its commitment. The title commitment and the title policy issued after closing are contracts for insurance. They are "not analogous to a warranty of title found in a deed." Federal Sav. & Loan v. Transamerica Title, supra 19 F.3d at 530. Although a title commitment is not a warranty of title, that is exactly how it is used in Provision 12.a of the standard form contract. Provision 12.a can mislead buyers and seller to believe the title commitment is intended as an abstract listing of all possible record encumbrances on title. The exceptions listed in the commitment reflect a title company

judgment as to insurance underwriting risks and are not a representation as to all possible encumbrances on title.

Provision 12.a uses the commitment as a representation of title without addressing any of its limitations. The title company is not a party to the standard form contract. It cannot explain the legal significance of using specific exceptions versus broad general exceptions to a seller's deed warranties without engaging in the unauthorized practice of law.

Third, Provision 12.a misleads buyers and especially sellers into believing they have a right to rely on the title commitment as a representation and warranty of title. If a seller is sued for a recorded encumbrance omitted from the title commitment, he may believe he can sue the title company for negligence. As noted above, however, the title commitment is not an abstract. It is an insurance contract with the buyer, and a seller has no right to rely on the commitment. Jimerson v. First American Title Ins. Co.; Arapahoe Land Title, Inc. v. Contract Financing, Inc., supra. The liability of a title company is measured by its insurance contract. The title company is not a party to the contract between buyer and seller. Its only agreements are its title commitment and title policy insurance contracts with the buyer.

The seller also cannot reasonably rely on the title commitment because of a potential conflict of interest with the title company. Under Provision 12.a every title exception not included in the title commitment benefits the buyer, but increases the potential warranty liability of a seller. Title companies also have a contractual right of subrogation in their insurance policies. If the title company has paid a claim by its buyer/insured, it could use its subrogation rights to pursue a breach of warranty claim against the seller. These potential conflicts are

present under Provision 12.a with its specific exceptions, but would not be present under a broad general deed warranty exception, such as for encumbrances of record.

Use of title commitment exceptions to determine a seller's warranty liability raises a number of complicated legal issues between the seller and title company, as well as between the seller and buyer. Since Provision 12.a is part of the standard form contract, only a seller's agent, if knowledgeable, or an attorney, could explain and advise a seller regarding these issues. When a transaction-broker or buyer's agent is involved, they cannot advise the seller, who is left to fend for himself, relying on the "neutrality" of a standard form approved by the Commission. The legal issues involved in determining a seller's deed warranties are too complicated to be addressed by a standard form provision. Provision 12.a, in particular, does not address the issue fairly or adequately.

Alternative Remedies For Provision 12.a

The title company is not a party to the standard Commission contract and, thus, does not expressly agree to Provision 12.a's use of title commitment work product as part of the conveyance deed. If, as a scrivener, the title company prepares such a deed, it may have ratified the use of its title commitment. Brokers, and not title companies, are the ones authorized to practice law and brokers are responsible for the deed under the standard Closing Instructions. If a problem develops with the deed's exceptions, however, the title company is likely to be blamed since those exceptions were taken from the title company's commitment. If Provision 12.a is not deleted or changed, there are a number of ways that its detrimental effects could be ameliorated.

There can be a disclaimer in the Closing Instructions, the contract and/or the title commitment, itself, that the commitment is not prepared as a representation or warranty of title and is not intended for that use. There can also be disclaimers added to the closing instructions specifying: a) that the title company has prepared the deed as a scrivener only; b) that the parties have relied on themselves, their brokers and attorneys for the appropriate form of the deed, including any specific warranty exceptions; and c) that with regard to preparation of the deed, they have not relied on the title company, and they acknowledge the title company has not acted as the agent of either party.