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TITLE INSURERS CONFRONT THE 'CLOGGING' DOCTRINE

As part of the historical development of mortgages, a concept known as **clogging of the equity of redemption** was developed. This doctrine prohibited the lender from exacting an unfair advantage from the borrower as part of the consideration for the mortgage loan. It may be broken down into three areas of concern:

♦ **"Once a mortgage, always a mortgage."** This principle makes void any provision in the mortgage which purports to limit or nullify the right of redemption.

♦ **"Collateral advantages" prohibited**. A "collateral advantage" is the right of a lender to receive something in addition to the repayment of principal and interest.

♦ **"Fettering" prohibited.** A fetter is an agreement which binds the mortgaged premises beyond the redemption period. In other words, after repayment of all principal and interest, the mortgagor is entitled to receive the property back "unfettered"; *i.e.*, in the same condition in which the mortgagor parted with it.

Modern instances in which the clogging doctrine may come into play usually (but not exclusively) involve commercial (or occasionally residential) transactions in which the mortgagee seeks to obtain additional security, at the time of closing, beyond that provided by the note and mortgage. This may take the form of an option to purchase the mortgaged premises, exercisable if an option to purchase given to the mortgagee. ***Humble Oil & Refining Co. v. Doerr***, 123 *N.J. Super*. 530 (Ch. Div. 1973).

A variation on this theme may involve a pledge of stock or LLC membership interests in the borrower entity in favor of the lender. If the borrower defaults, the lender may then effectively assume control of the borrower entity. Or the lender may insist that the borrower provide a deed in lieu of foreclosure [DIL] along with the mortgage, which may be recorded when the borrower defaults. (Although DILs provided to the lender after default by the borrower are generally considered to be valid. Weinstein, ***Law of Mortgages,*** §13.14 (2d Ed. 2001).) Such devices may be intended to avoid the need for a time-consuming foreclosure suit, during which the mortgagor may be able to raise equitable defenses, thereby delaying or preventing foreclosure. For more information see ***N.J. Title Practice***, §§ 81.16 & 81.17 (6th Ed. 2016).

The ***Restatement (Third) of Property, Mortgages,*** §3.1("The Mortgagor's Equity of Redemption and Agreements Limiting It") (1996), sets forth the clogging doctrine as follows:

(a) From the time the full obligation secured by a mortgage becomes due and payable until the mortgage is foreclosed, a mortgagor has the right to redeem the real estate for the mortgage…. (b) Any agreement in or created contemporaneously with a mortgage that impairs the mortgagor's right [to redeem] is ineffective…(c) An agreement in or created contemporaneously with a mortgage that confers on the mortgagee an interest in the mortgagor's real estate *does not violate this section, unless its effectiveness is expressly dependent on the mortgagor's default.* [Emphasis added.]

In ***Alliance Healthcare v. Jersey City Bergen, LLC,*** 2016 WL 6139811(Ch. Div. 2016) and ***Mercer Cty. Improv't Auth. v. Trenton Studios***, 2008 WL 3861996 (App. Div. 2008), discussed in ***Title Talk* No. 98** (Winter 2016-17), our courts found that the lender's ability to exercise its rights under the collateral documents was *not* dependent upon the borrower's default. Thus, the same were found to be valid in accordance with *Restatement* §3.1(c). It is nevertheless difficult, if not

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impossible, for a title insurer to predict whether a court will determine that the rights granted to the lender under such documents are or are not enforceable.

Consistent with the foregoing, many title insurers (including FNTG) have taken the position that special endorsements or affirmative insurance with respect to mortgages or collateral instruments containing features which may run afoul of the clogging doctrine may not be provided. Moreover, if the title company becomes aware that the lender is requiring the borrower to execute collateral instruments at the time of closing which provide additional security to the lender in the form of a DIL, an option to purchase the realty, or a stock or LLC membership pledge, etc., a so-called "creditor's rights" exception may be inserted in the policy:

Consequences of an attack on the estate or interest insured regarding or related to the [option agreement] [pledge agreement] [deed in lieu of foreclosure] [etc.], dated __________________, by and between [borrower entity] [member(s) / shareholders of borrower entity] and [lender].

Furthermore, if the title examination discloses that the current owner is a lender (or its affiliate), which has acquired title to the realty by exercising its rights under a collateral instrument (such as those discussed above), title insurers may be reluctant to insure the transaction, or may insist upon the insertion of an appropriate exception in the policy.

Of course, the foregoing does not apply to collateral instruments customarily provided in connection with commercial loans, such as UCC financing statements, assignments of leases and rents, etc. Nor does it apply to "shared appreciation" provisions found in the loan documents, for which the lender may request issuance of ALTA Endorsements Nos. 30-06 ("Shared Appreciation") or 30.1-06 ("Commercial Participation Interest"). In sum, the clogging doctrine continues to present difficulties for both lenders and title insurers.

MORTGAGE LENDING LAW AMENDED

The Legislature has amended the **Residential Mortgage Lending Act** [RMLA], through the enactment of **P.L. 2018, c. 108**, effective *ca*. November 22, 2018. RMLA was originally enacted in 2009 and codified as ***N.J.S.A.* 17:11C-51 *et seq***. It supplements the New Jersey Consumer Finance Licensing Act [NJCFLA], N.J.S.A. 17:11C-1 *et seq*., and repeals the Consumer Loan Law, N.J.S.A. 17:10-1 *et seq.;* the Secondary Mortgage Loan Act, N.J.S.A. 17:11A-34 *et seq.*; and the Mortgage Bankers and Brokers Act, N.J.S.A. 17:11B-1 *et seq*.

RMLA is of interest to title insurers in that it requires mortgage companies to provide loan proceeds in the form of a certified or cashier's check or by wire transfer upon the request of the borrower, the borrower's attorney, or other person acting for the borrower**. *N.J.S.A.* 17:11C-75(o).** This provision complements a section of the Title Insurance Act, ***N.J.S.A.* 17:46B-10.1**, which requires title companies to disburse only against "good funds".

The original version of RMLA also restricted fees which may be collected by residential mortgage lenders to (*inter alia*) "fees necessary to reimburse the mortgage lender for charges imposed by third parties." The amended version refers to "such other third party charges as the commissioner may expressly permit to lenders by rule in accordance with a procedure established by rule". ***N.J.S.A.* 17:11C-74** (as amended by P.L. 2018, c. 108). As discussed in ***N.J. Title Practice***, **§106.07** (4th Ed. 2016), the original version of this section (as supplemented by an administrative regulation) sometimes caused lenders to issue instructions suggesting that title companies could not (for example) charge settlement fees, or any other fee beyond the premium and search and examination fees.

The amended version of RMLA sets up a procedure for transitional licensing of mortgage loan originators [MLOs] who are currently licensing in another jurisdiction. In addition, the law states the allowable fees which may be charged by mortgage companies and defines each one. The list includes "commitment fee", "origination fee", "discount point", "warehouse fee", etc.

P.L. 2018, c. 108 also amends a section of the Title Insurance Act, ***N.J.S.A.* 17:46B-30.1,** to delete an obsolete statutory reference and substitute "the New Jersey Residential Mortgage Lending Act…" therefor. Thus, the amended version of the statute confirms that those licensed under RMLA are **not** eligible to receive a title insurance producer license. *N.J.S.A*. 17:46B-30.1 similarly prohibits certain other lending institutions from obtaining such licenses.

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VACANT AND ABANDONED PROPERTIES REGISTRATION: AN UPDATE

As discussed in ***Title Talk*** **No. 98** (Winter 2016-17), a statute permits each municipality to adopt an ordinance requiring municipal officials to "identify abandoned property for the purpose of establishing an abandoned property list". ***N.J.S.A.*** **55:19-55.** The Abandoned Properties Rehabilitation Act, ***N.J.S.A.*** **55:19-78 *et seq.***, permits municipalities to take action against abandoned properties so as to permit their rehabilitation. The Vacant and Abandoned Residential Properties Foreclosure Act, ***N.J.S.A.*** **2A:50-73**, amends the Fair Foreclosure Act, ***N.J.S.A*** **2A:50-53 *et seq.*,** to permit mortgage lenders to foreclose mortgages in summary fashion encumbering vacant and abandoned properties. The Legislature has amended the In Rem Tax Foreclosure Act**, *N.J.S.A.*54:5-104.29 *et seq.*,** to allow non-municipal holders of tax sale certificates encumbering abandoned properties to foreclose *in rem.* **P.L. 2015, c. 16,** amending **N.J.S.A. 54:5-86** and **54:5-104.30 *et seq*.** Finally, ***N.J.S.A.*** **46:10B-51** requires lenders to notify municipalities when foreclosures against residential properties are commenced. ***N.J.S.A*** **46:10B-51.1** requires those who acquire title to non-owner occupied residential properties by foreclosure or deed in lieu thereof to notify municipalities of the same.

It is obvious from the spate of legislative activity recounted above that the problems associated with vacant and abandoned properties continue to plague many communities. Some municipalities have engaged contractors to compile lists of such properties and have enacted ordinances imposing registration fees upon their owners. Fines or penalties may be imposed upon those who fail to register or pay fees. In some instances, the municipalities may treat the unpaid registration fees or fines as liens (despite the apparent lack of statutory authority for the same), so that liability for the unpaid fees (or fines) may presumably be imposed upon subsequent purchasers. Nevertheless, the fees (or fines) may or may not be reflected on tax searches (whether official or unofficial).

A judicial challenge to municipal ordinances imposing liens for unpaid registration fees was inevitable. In *Empire T4F Jersey Holdings LLC et al. v. Community Champions Corporations et al.* (Docket No. L-597-17), several tax sale certificate holders filed suit in the Law Division, Gloucester County, against the boroughs of Glassboro and Paulsboro, the townships of Monroe and Deptford, and Pro Champs, an entity engaged by many municipalities to locate and compile lists of vacant and abandoned properties. Plaintiffs alleged that the ordinances were invalid to the extent that they purported to impose liens for unpaid fees.

The suit was settled by a consent order which requires the defendant municipalities to adopt new ordinances omitting the offensive lien provisions. The text of the sample ordinance attached to the consent order provides that liens may be imposed only for repairs or abatement costs (which are authorized under the existing statutory scheme). Although the consent order is not binding on non-parties, it is hoped that other municipalities whose ordinances impose liens for unpaid registration fees will take heed and voluntarily amend their ordinances accordingly.

From the title insurer's standpoint, municipal fees and charges which do not constitute liens are beyond the scope of coverage afforded by the policy. On the other hand, where the municipality takes the position (even if unfounded) that an unpaid registration fee, fine or penalty constitutes a lien, the title insurer may require payment at closing or include an appropriate exception in the policy.

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THE HIDDEN DANGERS OF 'ESCROW' CLOSINGS: *Bianchi v Ladjen*

So called "escrow" closings can have unforeseen consequences, as demonstrated by the following tale. In October, 2013, Mario Bianchi contracted to purchase a single-family home in Glen Rock from Boris and Nadia Ladjen on a cash basis. As is customary, the contract placed the risk of loss on the sellers until the closing. Buyer and sellers were engaged counsel to represent their respective interests. Main Street Title & Settlement Services was retained to insure title and act as settlement agent. Closing was held on December 31, 2013. Although the contract permitted the balance of the purchase price to be paid by cash or certified or attorney trust account check, Main Street required that Bianchi wire the funds, so that they would be available for disbursement at closing.

However, Bianchi did not wire the money, but instead arrived at the closing table with certified checks. It was thus
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THE HIDDEN DANGERS OF 'ESCROW" CLOSINGS: *Bianchi v Ladjen* (cont'd from page 3)

agreed that the closing proceeds would be held in escrow until the checks "cleared". A simple escrow agreement was signed by the buyer and sellers; it read: "All closing proceeds, deed and keys will be held in escrow by Main Street Title until the funds clear. All the undersigned parties agree to this."

Although the record reflects some disagreement about subsequent events, it seems that Bianchi's attorney contacted Main Street between January 2nd and 6th and was advised that the checks had "cleared".

On the 7th, Bianchi, having obtained the keys, entered his new home. He discovered to his dismay that the furnace was not working, and that, owing to the cold weather, the pipes had frozen, causing substantial damage. Apparently because not mortgage financing was involved, Bianchi had not secured homeowners' insurance coverage prior to closing.

Bianchi filed suit against (a) the sellers; (b) the title company; and (c) his lawyer. The Law Division, in an unreported decision, entered judgment for defendants, and the Appellate Division, in an unreported *per curiam* opinion, affirmed. ***Bianchi v. Ladjen*, 2018 WL 1901945 (App. Div. 2018).** The case attracted considerable attention, with the New Jersey State Bar Association, the New Jersey Land Title Association, and the New Jersey Association for Justice, all appearing as *amici curiae.*

As noted above, the contract placed the risk of loss on the sellers until "closing". But when did the closing occur? The term is not defined in the contract. Citing previous decisions, the Appellate Division noted that the closing is normally understood as the time at which title passes from seller to buyer. But in this case the escrow agreement was a complicating factor. The panel agreed with the trial court that the risk of loss remained with the sellers until the checks cleared. When did this happen? Although it is unclear from the record, the Appellate Division believed that it occurred on January 2nd, at which point the risk of loss shifted to the buyer. Did the pipes freeze before or after this date? Again, based on the evidence presented to the trial court, the panel concluded that the plaintiff had failed to prove that the pipes froze before January 2nd.

In dismissing plaintiff's malpractice claim against his attorney for alleged failure to advise him to obtain homeowners' insurance, the court noted that the expert report submitted was a "net opinion": It was conclusory in nature and failed to demonstrate that the attorney had failed to observe the requisite standard of care owed to his client. With respect to Main Street, the complaint alleged that the title company failed to (a) prepare an adequate escrow agreement; and (b) notify Bianchi or his attorney promptly when the checks had cleared. In rejecting these arguments, the court found that plaintiff's expert report was a net opinion, which failed to demonstrate the Main Street owed plaintiff a duty in respect to these contentions. In sum, one cannot be held liable for the breach of a non-existent duty. Accordingly, the Appellate Division affirmed the judgment of the Law Division.

FNTG AGENCY DEPT. WELCOMES JAMIE CHADWICK

We are pleased to announce that **Jamie Chadwick** has joined the FNTG agency team as Regional Technology Trainer for PA and NJ. Jamie has been involved in the title and real estate industries since 1992, when she began her career in Philadelphia as a settlement agent for Olde City Abstract. Before joining FNTG, she was employed by SMS Corporation (owner of the Title Express and Streamline software programs) as a software consultant for almost 6 years. Jamie's vast knowledge of the settlement and closing process – beginning with search and examination of title to the closing itself – will be a critical asset in assisting agents in finding the most efficient processes to meet the needs of their clients and providing the best experience possible for them. Jamie may be contacted via e-mail at **Jamie.Chadwick@fnf.com.**

Jamie was born and raised in Philadelphia and now lives in Atlantic City, NJ. She holds a Bachelor of Arts degree in History from Rutgers University, and she is a volunteer and board member for Oceanside Family Success Center. Jamie is Co-Chair of the Sr. Seamus Walk Committee, which raises funds for Our Lady Star of the Sea Regional School in Atlantic City. She is the proud aunt to three incredible nephews and has a passion for cooking, which many of her friends and family appreciate.

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