

SUPREME COURT OF THE STATE OF NEW YORK – NEW YORK COUNTY

PRESENT: Ramos

PART 53

Justice

Route 747 Investors

- v -

Commonwealth Landtit.
Inc.

E-FILE

INDEX NO.

602352/09

MOTION DATE

MOTION SEQ. NO.

001

MOTION CAL. NO.

The following papers, numbered 1 to _____ were read on this motion to/for _____

Notice of Motion/ Order to Show Cause – Affidavits – Exhibits ...

Answering Affidavits – Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED

RECEIVED

APR 27 2010

MOTION COURT CLERK'S OFFICE
NYS SUPREME COURT - CIVIL

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion

*is decided in accordance with
accompanying memorandum decision and order.*

MCR

Dated: 4/19/2010


CHARLES E. RAMOS J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Check if appropriate: DO NOT POST REFERENCE

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION

E-FILE

-----x
ROUTE 747 INVESTORS I, LLC,

Index No. 602352/09

Plaintiff,

-against-

COMMONWEALTH LAND TITLE INSURANCE,

Defendant.
-----x

Charles Edward Ramos, J.S.C.:

Defendant Commonwealth Land Title Insurance Company
(Commonwealth) moves to dismiss the complaint (CPLR 3211 [a] [1],
[7]).

Background¹

This action arises out of the loss of escrow funds following the transfer by plaintiff Route 747 Investors, I, LLC (Route 747) of its escrow arrangement from Commonwealth, a title insurance underwriter, to non-party Liberty Title Agency LLC, Commonwealth's agent, upon the urging of Commonwealth's former vice president, Douglas Forsythe, who became employed at Liberty.

In June 2007, non-party Savanna, a commercial real estate developer and predecessor-in-interest to Route 747, entered into an escrow agreement with Commonwealth (Escrow Agreement), in connection with Savanna's purchase of two parcels of property. In addition to being the escrow agent, Commonwealth was obligated to provide title insurance at closing (Escrow Agreement). The

¹ The facts set forth herein are taken from the pleadings, unless otherwise noted, and are assumed to be true for the purposes of disposition.

Escrow Agreement was negotiated by Forsyth.

In 2008, Forsyth left Commonwealth and began employment at Liberty, a company that shared with a long-standing agency relationship with Commonwealth with respect to escrow, title and closing matters.

Subsequently and purportedly with Commonwealth's knowledge and consent, Forsyth requested that Savanna agree to the appointment of Liberty as escrow agent under the Escrow Agreement in lieu of Commonwealth.

On February 27, 2009, Route 747 consented to the appointment of Liberty as successor escrow agent, while Commonwealth was to remain the issuer of title insurance at closing, under an executed amendment to the Escrow Agreement (Amended Escrow Agreement).

Unbeknownst to Route 747, at the time of the appointment of Liberty, Commonwealth had developed suspicions regarding Liberty's handling of various clients escrow funds, and conducted an internal audit that concluded that Liberty had been engaged in a fraudulent scheme to misappropriate funds.

On March 3, 2009, just days after Liberty's appointment as successor escrow agent under the Amended Escrow Agreement, Commonwealth terminated its agency relationship with Liberty. Commonwealth did not inform Route 747 of its suspicions or its eventual termination of Liberty.

On March 5, 2009, two days after Commonwealth's termination of Liberty as agent, Savanna deposited \$358,959.95 with Liberty

to be held in escrow pursuant to the Amended Escrow Agreement. Shortly thereafter, it learned that Liberty had absconded with the funds.

In April 2009, Commonwealth and other title insurance underwriters commenced an action against Liberty and its president, Brian Madden, in New York County on the basis of the alleged fraudulent scheme to misappropriate clients' escrow funds (Underwriters' Action) (Exhibit C, annexed to the Ringer Aff. in Opp.). At some point, Madden was charged with several criminal counts of fraud.

After Route 747 learned of the action, it demanded that Commonwealth indemnify it for the loss of the escrow funds, which Commonwealth refused.

Thereafter, Route 747 commenced this action against Commonwealth and asserts four claims: (1) breach of contract, stemming from Commonwealth's failure to ensure that funds were held in segregated accounts, and failure to supervise its agent, Liberty; (2) negligence, premised upon Commonwealth's failure to properly monitor and supervise its agent, Liberty; (3) breach of fiduciary duty, for failure to disclose its suspicions about Liberty and its termination of Liberty's agency; and (4) breach of its duty to disclose, based on largely identical allegations.

Discussion

I.

Commonwealth moves to dismiss the complaint pursuant to CPLR 3211 (a) (1) on the basis of a defense founded upon documentary

evidence, namely, an exculpation clause contained in the Escrow Agreement, that it claims bars all of Route 747's claims.

The common business practice of limiting liability by restricting or barring recovery by means of an exculpatory provision, although disfavored by the law and closely scrutinized by courts, is accorded judicial recognition where it does not offend public policy (*Bank of America Securities LLC v Solow Building Co. II, L.L.C.*, 47 AD3d 239, 244 [1st Dept 2007]). Clauses that seek to immunize actors from willful, fraudulent, or grossly negligent conduct with reckless indifference to others are unenforceable (*Id.*).

Here, the exculpation clause immunizes Commonwealth from liability except for "willful misconduct or gross negligence," and releases it from any acts or omissions done in good faith in the performance of its duties (Escrow Agreement, § 11).

At the time that the escrow funds were misappropriated, Commonwealth was not escrow agent, nor was it in possession of escrow funds as the result of the substitution of Liberty as successor escrow agent under the Amended Escrow Agreement.

Nonetheless, for the reasons stated below, Route 747 alleges in sufficient detail that Commonwealth acted with gross negligence when it failed to notify Route 747 that it had terminated its agency relationship with Liberty due to Liberty's criminal conduct, while it knew that Route 747 was relying upon this relationship. These allegations, if proven true, may be sufficient to overcome the exculpatory language of the Escrow

Agreement if a fact-finder determines that Commonwealth acted unreasonably and with gross negligence.

In any event, because the tortious conduct that Route 747 alleges did not occur while Commonwealth was performing its contractual duties, the exculpatory clause is arguably inapplicable to the conduct at issue.

Consequently, Commonwealth has failed to meet its burden that documentary evidence conclusively resolves all factual issues and that Route 747's claims fail as a matter of law (*Robinson v Robinson*, 303 AD2d 234, 235 [1st Dept 2003]).

II.

A. Breach of Contract

The claim for breach of contract is premised upon Commonwealth's alleged failure to maintain its escrow deposits in segregated interest bearing accounts by not properly supervising its agent, Liberty.

Route 747 does not point to a specific contractual provision of the Amended Escrow Agreement that requires Commonwealth to supervise Liberty to insure that the escrow accounts are maintained in a certain manner.

Rather, under the express terms of the Escrow Agreement, Commonwealth had "no [contractual] duty to ... enforce any obligation of any person to perform any other act" (Escrow Agreement, § 17). Further, it is Liberty's obligation, as successor escrow agent, to manage the escrow funds (Amended Escrow Agreement, § 4).

Consequently, the claim for breach of contract is not viable, for failure to allege violation of any particular contractual provision (*Kraus v Visa Intl. Service Assoc.*, 304 AD2d 408 [1st Dept 2003]).

B. Tort Claims

Commonwealth moves to dismiss the claims for negligence, breach of fiduciary duty and failure to disclose on the grounds that it was under no duty to notify Route 747 of its suspicions regarding Liberty, and cannot be held liable for Liberty's criminal conduct, pursuant to CPLR 3211 (a) (7).

Route 747 contends that it sufficiently pled that Commonwealth was under a duty to disclose under negligence and breach of fiduciary duty theories, in addition to the doctrine of apparent authority by estoppel.

According to Route 747, Commonwealth's termination of Liberty due to its discovery of its criminal conduct towards Commonwealth's customers as a result of its acting as an agent for Commonwealth imposed a duty of care upon Commonwealth to notify Route 747, at a minimum, of the termination of that relationship.

The threshold question in any negligence action is whether the defendant owes a legally recognized duty of care to the plaintiff (*In re New York City Asbestos Litig.*, 5 NY3d 486, 493-94 [2005]). Where a plaintiff seeks to extend liability to a defendant for failure to control the conduct of others, the "key consideration" critical to the existence of a duty is that "the

defendant's relationship with either the tortfeasor or the plaintiff places the defendant in the best position to protect against the risk of harm" (*Id.*).

Route 747 alleges, and the Court must accept as true, that it substituted Liberty as successor escrow agent at the behest of Liberty's former vice president, and in reliance upon Liberty's long standing commercial, contractual, fiduciary and agency relationship with Commonwealth. This agency relationship is even alleged by Commonwealth in its pleadings in the Underwriters' Action (Complaint, §§ 2, 4, 8, 22, 82-89), and thus, constitutes an informal judicial admission (*Addo v Melnick*, 61 AD3d 453, 457 [1st Dept 2009]).

Recognizing a duty of care on Commonwealth's part turns on the fact of Commonwealth's agency relationship with Liberty and its purported awareness that Route 747 was specifically relying upon this relationship when Route 747 agreed to substitute Liberty as successor escrow agent, that arguably placed Commonwealth in the "best position" to protect against the risk of harm to Route 747.

Beyond Commonwealth's unique position to protect against the risk of harm, the question arises to what extent, if any, Commonwealth was obligated to extinguish the lingering appearance of Liberty's agency once it terminated its relationship with Liberty.

The doctrine of apparent authority by estoppel developed under the law of torts to compensate an innocent person for loss

suffered by those who reasonably rely upon words or conduct of a principal that leads to misapprehension of the appearance of authority on the part of an agent (*Hallock v State*, 64 NY2d 224, 231 [1984]; Restatement [Second] of Agency § 8, comment d).

Where the innocent third party can demonstrate that it reasonably relied on the principal's conduct, the principal will be barred from disavowing the transaction of the apparent agent where it would be unjust (*Id.*; *Hallock*, 64 NY2d at 231; *Ford v Unity Hospital*, 32 NY2d 464, 472-73 [1973]; *Clarke v Montgo Realty Inc.*, 2 Misc 3d 135[A], *1 [Sup Ct, App Term 2004; Restatement [Second] of Agency §§ 8b, comments a, c, 27, 267).

Here, Commonwealth failed to take steps to notify Route 747 that it had terminated its agency relationship as the result of its discovery of Liberty's criminal conduct or otherwise strip it of apparent authority. According to Route 747, it reasonably relied upon the lingering appearance of agency when it agreed to the substitution of Liberty as successor escrow agent, and deposited the escrow funds.

Further, Route 747 deposited the escrow funds with Liberty two days after Commonwealth terminated Liberty's agency on March 5, 2009, which it clearly would not have done had it been notified by Commonwealth of the termination. Thus, Route 747 sufficiently alleges that the failure to notify of the termination or take steps to strip Liberty of apparent authority proximately caused its harm.

For these reasons, Route 747 sufficiently alleges that

Commonwealth owed it a duty of care to notify Route 747 of Liberty's termination due to criminal conduct or take steps to strip Liberty of any lingering appearance of authority.

Evaluating whether Commonwealth's conduct rises to the level of gross negligence involves questions of fact that cannot be evaluated on a pre-answer motion to dismiss (*Banc of America Securities LLC*, 47 AD3d at 252).

In *Johnson v Nationwide General Insurance Agency Co.* (937 F Supp 186 [ND NY 1996]), upon which Route 747 relies, the defendant, an insurance company, terminated one of its agents for improprieties relating to his handling of customer funds. The defendant allegedly sent a form letter to each of the terminated agent's current customers indicating that the agent was no longer employed there.

It appears that the plaintiff did not receive the form letter because the agent closed her account without her permission, after making unauthorized withdrawals. Subsequent to his termination, the agent approached plaintiff and solicited additional funds from her, and represented that he was still an agent for the defendant. He embezzled her funds, and was ultimately convicted of larceny.

The court sustained plaintiff's claim to hold the defendant liable for the lost funds because it did not take sufficient action to eliminate any appearance that the agent had authority to represent it.

The court stated:

"When an agent is terminated due to criminal activity during the course of his agency, all reasonable and practical actions and communications must be taken by the principal to assure that third parties are aware of the termination, and that the former agent has no authority to act for the principal in any shape, form or manner, and that it would be fraudulent for him to so act" (*Id.* at 192).

Here, as in *Johnson (Id.)*, Commonwealth was aware of Liberty's criminal conduct and improper actions towards its customers, including Route 747, that were relying upon Commonwealth's agency relationship with Liberty.

Although Route 747 does not allege that Commonwealth intentionally misled it as to Liberty's authority, a fact-finder could conclude that Commonwealth's silence, under the circumstances, was unreasonable.

Moreover, the determination that Commonwealth owes Route 747 a duty to disclose does not run afoul of the concern for limitless liability articulated by the Court of Appeals in *In re New York City Asbestos Litig.* (5 NY3d at 493).

Commonwealth was in the best position to prevent Route 747's loss due to its discovery of Liberty's criminal conduct, and its purported awareness that its long-standing agency relationship was widely known (*see Johnson*, 937 F Supp 186; Restatement [Second] of Agency § 8b, comments c-e).

Alternatively, Route 747 sufficiently alleges the existence of a duty to disclose under the so-called "special facts" doctrine. A duty to disclose arises where one party's superior knowledge of material facts renders a transaction without disclosure inherently unfair, where the facts are peculiarly

within that party's possession, and that information could not have been discovered through the exercise of ordinary diligence (*Jana L. v West 129th Street Realty Corp.*, 22 AD3d 274, 277-78 [1st Dept 2005]).

Route 747 sufficiently alleges that the discovery of Liberty's criminal conduct by Commonwealth's internal audit was peculiarly within Commonwealth's knowledge, and Route 747 was unable to discovery the termination of Liberty's agency by due diligence because this information was not publicly available at the time.

Finally, the alleged factual circumstances did not give rise to a duty on Route 747's part to inquire (see *Collision Plan Unlimited, Inc. v Bankers Trust Co.*, 63 NY2d 827, 832-31, rearg denied 64 NY2d 755 [1984]; *Decana Inc. v Contogouris*, 55 AD3d 325, 325-26 [1st Dept 2008], *lv dismissed* 11 NY3d 920 [2009]).

However, Route 747 does not allege that it placed higher trust or confidence in Commonwealth that would transform the relationship into a fiduciary one (*EBC I, Inc. v Goldman Sachs & Co.*, 5 NY3d 11, 19-20 [2005]).

Accordingly, it is

ORDERED that defendant's motion to dismiss is granted, in part, and the first and third causes of action are dismissed, and is otherwise denied; and it is further

ORDERED that defendant is directed to serve an answer to the complaint within 10 days after service of a copy of this order with notice of entry.

Dated: April 19, 2010

ENTER:



J.S.C.

CHARLES E. RAMOS