

Claims Against Professionals Arising from Real Estate Flipping Schemes

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I. What is Real Estate Flipping?

THERE are two types of Real Estate Flipping: the legal and the illegal type of real property flipping. Illegal flipping is when one buys a house at a low price and then resells it at a higher price within a short time frame, often after making only cosmetic improvements to the property. Legal real estate flipping has been the subject of a number of television programs, including “Flip This House” on A&E or “Property Ladder” on the TLC Channel.

Illegal flipping is “a predatory lending practice whereby a recently acquired property is resold for a considerable profit with an artificially inflated value within a short period of time.”¹ The legal flip transforms into an illegal flip when fraud, misrepresentation or deceit become an integral part of the transaction.² Illegal flipping is accomplished by “mortgage industry insiders using ‘straw buyers’ to defraud lending institutions, public and private investment firms and the United States Department of Housing and Urban Development (HUD) by submitting false information in mortgage applications.”³ “Straw buyers” are provided with fraudulent

¹ FBI, Privacy Impact Assessment (PIA), *Mortgage Fraud - Property Flipping Database*, (Dec. 28, 2005), http://foia.fbi.gov/property_flipping.htm (last visited Nov. 18, 2008).

² Fannie Mae, *Announcement 04-07* (Nov. 28, 2004), <https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2004/04-07.pdf>, (last visited Nov. 18, 2008).

³ *Id.*



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documentation (i.e., W-2 forms, tax forms, false appraisals, etc.).”⁴ The property is “then sold at up to 500% of its true appraised value.”⁵ “Risk of default on these properties is significant.”⁶ “Lending institutions, investors, HUD, and private insurers often suffer substantial losses.”⁷ Consequently, flipping is a type of mortgage fraud, which is “one of the fastest growing white-collar crimes in the United States.”⁸ Mortgage fraud is defined as “a material misstatement, misrepresentation, or omission relied upon by an underwriter or lender to fund, purchase, or insure a loan.”⁹

A quintessential example of an illegal property flipping/mortgage fraud case involved a New Jersey attorney, Stanley Yacker. In January 2002, Yacker admitted to “his role in a scheme to defraud purchasers of over-valued and fraudulently mortgaged homes in Monmouth County, New Jersey and elsewhere and to engaging in more than 200 ‘land flip’ transactions with straw buyers.”¹⁰ Yacker stated “that those property transactions involved straw buyers who were paid for the use of their names and credit histories to obtain fraudulent mortgages for the properties.”¹¹

Yacker admitted “he acted with [realtors Irene] DiFeo and [Donna] Pepsny, among others, to engage in a scheme to defraud and to obtain money and property by means of false and fraudulent pretenses, representations, and promises, involving persons he represented in connection with their purchases of homes in 1995 and

1996.”¹² Specifically, Yacker committed a variety of fraudulent acts, including:

- misrepresenting the nature and interest rate of the mortgage loan for which the purchaser had qualified - by failing to adequately explain the nature and consequences of the balloon first mortgage and the fact that tax payments were not included in the first mortgage payment - and the amount of the resulting monthly payment;

- failing to disclose to purchasers that, as a result of the purchaser's minimal down payment and the fraudulent increase of the purchase price, the seller would require the purchaser to execute at closing and become responsible for a second mortgage, thereby increasing the purchaser's monthly mortgage obligations;

- concealing the fact that some purchasers received funds out of closing to make repairs, by issuing checks to the purchasers in the names of other persons or entities;

- causing the falsification of numerous documents related to the transaction, including HUD-1/RESPA settlement statements which disguised the true nature and details of the transaction;

- failing to advise his purchaser-clients to abandon the closing when it was in their best interest to do so, and in fact encouraging or pressuring them to complete the closing under those circumstances, even after acknowledging in at least one instance that the purchasers' signatures on a contract of sale had apparently been forged or falsified;

- in one instance creating a fictitious sale of a property to a purchaser's relative who would then convey the property to the actual purchaser, in order to justify a false increase in the

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ FBI, Privacy Impact Assessment, *supra* note 1.

⁸ FBI, *Operation Quick Flip*, <http://www.fbi.gov/page2/dec05/operationquickflip121405.htm> (last visited Nov. 18, 2008).

⁹ *Id.*

¹⁰ United States Department of Justice, *Monmouth Lawyer Admits Arranging More Than 200 “Land Flip” Deals* (Jan. 15, 2002),

http://www.usdoj.gov/usao/nj/press/files/ya0115_r.htm (last visited Nov. 18, 2008).

¹¹ *Id.*

¹² *Id.*

final purchase price of the home and to inflate the amount of the mortgage loan available for the transaction;

- creating the false appearance in the mortgage loan file that the debts of the purchasers were paid off as part of the closing, as required by a lender, by photocopying checks written by the purchasers which . . . then [were] returned to them;

- failing to record deeds to establish and protect the purchasers' interests in their properties.¹³

Yacker also admitted that in 1996 and 1997, “Gary Grieser and others solicited and located persons willing to act as straw buyers in numerous transactions, whereby mortgage loans would be obtained and the properties acquired in the names of the straw buyers, even though those individuals had no interest in obtaining such loans or purchasing such properties.”¹⁴ “After the closing on those properties, each straw buyer conveyed a 60-percent interest in the given property to Grieser's entity, Capital Assets, in a joint venture arrangement which left the straw buyer holding a 40-percent interest as co-owner with Capital Assets.”¹⁵

Yacker “prepared the joint venture agreement used in those transactions.”¹⁶ “Yacker also acknowledged that he knew that each of the straw buyers was being paid for the use of their names and credit histories in obtaining the subject mortgage loans and in acquiring the subject properties.”¹⁷ Yacker also committed various fraudulent acts to further the straw buyer scheme, including:

- issuing false letters regarding non-existent deposits of funds by purchaser-

borrowers, which funds he claimed to be holding in escrow;

- closing title on the resale portion of flip transactions knowing that the original purchase of the property had not yet closed; and

- signing and causing straw buyers to sign false and fraudulent closing documents, including HUD-1/RESPA settlement statements which did not truthfully describe receipts and disbursements of funds, and affidavits that falsely asserted that the straw buyer would be residing in the subject property.¹⁸

Yacker pleaded guilty “to all 10 counts of an Indictment, which charged him with conspiracy to commit wire fraud and nine counts of wire fraud.”¹⁹ In 2003, Yacker was sentenced to “18 months in prison and ordered . . . to pay an unspecified portion of \$787,985.00 in restitution.”²⁰ Unfortunately, the claims against Yacker are not unique or limited to New Jersey. Illegal flipping schemes are taking place nationwide:

In Atlanta, Georgia, “Chalana McFarland was an attorney who operated her own law firm.”²¹ McFarland acted as both the “title agent for a title insurance company as well as the closing attorney for various lenders.”²² She then “used the stolen identity of numerous victims to submit false fraudulent loan applications.”²³ The appraisals were “inflated and straw buyers were used to complete the fraudulent sales of over 100 properties.”²⁴ “McFarland paid her identity thief \$10,000 per stolen identity, as well as paying the appraiser who

¹³ *Id.*

¹⁴ *Id.*

¹⁵ United States Department of Justice, *Monmouth Lawyer Admits Arranging More Than 200 “Land Flip” Deals*, *supra* note 10.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ Rick Hepp, *Matawan lawyer given 18-month term for role in ‘House of Cards’*, ASBURY PARK PRESS, June 17, 2003 (on file with author).

²¹ FBI, *Operation Quick Flip*, *supra* note 8.

²² *Id.*

²³ *Id.*

²⁴ *Id.*

inflated property values over \$400,000.”²⁵ The fraudulently obtained mortgages valued in excess of \$20 million with losses in excess of \$12 million.²⁶ “McFarland and 16 other subjects were indicted” and “[f]ifteen have been sentenced, with McFarland receiving 30 years in prison”²⁷

In Fort Lauderdale, Florida, a federal grand jury “returned an 11 count indictment charging seven individuals with conspiracy to commit bank fraud, HUD fraud and false statements on more than 120 loan applications,” totaling more than \$15 million dollars.²⁸ The mortgage fraud was “predicated on a flipping scheme” where a “real estate investor would purchase homes and, on the same day, resell them at inflated prices to unqualified buyers he had recruited.”²⁹ The buyers were almost always “first time homebuyers and/or recent immigrants” who “did not have sufficient income or assets to pay the required down payment and closing costs so, the real estate investor would illegally provide funds to them and incorporate these costs into the price of the over-inflated loans.”³⁰

In Baltimore, Maryland, a “property speculator, two loan originators, an appraiser, and a settlement attorney were indicted for engaging” in a scheme to “acquire inexpensive homes and fraudulently qualify buyers to purchase the properties at much higher prices.”³¹ The “majority of over 100 settlement statements contained false information about the buyers’ and sellers’ monetary contributions to the transactions.”³² Appraisers “overstated [the] property values and

misrepresented ownership at the time of the sale.”³³

In Newark, New Jersey, Thomas Fauntleroy and David Bowie admitted to inducing the FHA to “insure mortgage loans valued over \$1 million, made by Neighborhood Mortgage (owned by Bowie) to unqualified buyers.”³⁴ “In support of the FHA loan applications, the defendants allegedly created and submitted false and fictitious bank statements, leases, IRS Forms W-2, verifications of past mortgage payments, pay stubs, attorney escrow letters, gift letters, verifications of employment, deposit checks, and fraudulent property appraisals.”³⁵ Fauntleroy was sentenced to 21 months in prison and ordered to pay \$524,000.00 in restitution.³⁶ Bowie was sentenced to 12 months in prison and ordered to pay \$500,000.00 in restitution.³⁷ Another of Fauntleroy’s co-conspirators, attorney Peter Port was sentenced to five months in prison.³⁸ Port, who “served as the title agent on many of the properties involved in Fauntleroy’s schemes, pleaded guilty to one count of providing false statements for the purpose of producing false documents used in the scheme.”³⁹ The court ordered Port “to pay \$510,000, which he paid in full at sentencing.”⁴⁰

In Nevada, Mark Young, a former Nevada First Residential Mortgage Company branch manager, “directed loan officers and processors in the origination of 233 fraudulent FHA loans valued at over

²⁵ *Id.*

²⁶ FBI, *Operation Quick Flip*, *supra* note 8.

²⁷ *Id.*

²⁸ *Hearing Before the S. Subcomm. on Investigations Comm. on Gov’t Affairs*, 107th Cong. 2 (2002) (statement of Susan Gaffney, Inspector General of Dep’t of Hous. & Urban Dev.).

²⁹ *Id.*

³⁰ *Id.*

³¹ *Id.*

³² *Id.*

³³ *Hearing Before the S. Subcomm. on Investigations Comm. on Gov’t Affairs*, *supra* note 28.

³⁴ FBI, *Operation Quick Flip*, *supra* note 8; see also Flippingfrenzy.com, *Anatomy of a Mortgage Fraud Scheme*, www.flippingfrenzy.com/2006/03/30/anatomy-of-a-mortgage-fraud-scheme (last visited Nov. 18, 2008) (article identifies defendants as Barry Fauntleroy and Devon Bowie).

³⁵ FBI, *Operation Quick Flip*, *supra* note 8.

³⁶ *Anatomy of a Mortgage Scheme*, *supra* note 34.

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.*

\$25 million.”⁴¹ Young conspired with “other mortgage company employees and with employees of General Realty to manufacture and submit false employment and income documentation for borrowers.”⁴² “Most of the borrowers were illegal immigrants from Mexico.”⁴³ At minimum, “58 loans with a total value of \$6.2 million have gone into default, with a loss to HUD of over \$1.9 million. The Nevada First Residential Mortgage Company is no longer in business.”⁴⁴ On September 1, 2005, Mark Young was “found guilty on 32 counts of submitting false information to HUD, and one count of conspiracy.”⁴⁵

In Cincinnati, Ohio, Randall Davidson “used unsuspecting buyers from Pittsburgh, Pennsylvania” to purchase depressed properties in Dayton, Ohio.⁴⁶ “These properties were purchased at an inflated rate using falsified documents to secure the loans.”⁴⁷ Davidson “maintained a business office in Pittsburgh” and Dayton.⁴⁸ In addition, the “closing agent would disburse funds prior to receiving the down payment checks in order to provide Davidson and other co-schemers with money. The closing agent was aware that many of the documents used in order to secure the loans were falsified, but continued to close the loans.”⁴⁹ Inevitably, Davidson would “receive a large cash profit during the disbursement of funds” and to date, “the known loss is over \$8 million.”⁵⁰

Recently, a property appraiser in New Jersey plead “guilty to conspiracy to commit wire fraud”⁵¹ Michael

Meehan, as part of a larger property-flipping scheme by NJ Affordable Homes, would receive “sales contracts with prices far exceeding properties’ values” as well as “a list of improvements purportedly made to the propert[ies]” from an employee at NJ Affordable.⁵² Meehan would “appraise[] the homes to generally match that price.”⁵³ While Meehan was to have appraised about 100 properties, Meehan admitted in court that “he inspected some . . . but not all” of those properties and nevertheless included the “alleged renovations on his appraisals.”⁵⁴ Meehan faces up to five years in prison.⁵⁵ He has already “surrendered his appraisal license . . . and agreed to pay a \$1,000 fine.”⁵⁶

In 2005, the FBI reported losses of \$1,014,000,000 from illegal real estate property flipping schemes and mortgage fraud, up from \$429,000,000 in 2004.⁵⁷ According to a United States Treasury Department study in November 2006, mortgage fraud reports “filed by banks and other heavily regulated financial institutions . . . nearly doubled between 2003 and 2004.”⁵⁸ This increase “continued a longer-term trend that saw a 1,411 percent” increase in such reports between 1997 and 2005.⁵⁹

II. PARTIES

Who are the potential players involved in a flipping scheme?

Seller

1. Attorney
2. Real Estate Broker

⁴¹ FBI, *Operation Quick Flip*, *supra* note 8.

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ FBI, *Operation Quick Flip*, *supra* note 8.

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ Greg Saitz, *NJ Affordable Appraiser Admits Role in Fraud*, STAR-LEDGER, Mar. 14, 2007, at 21 (on file with author).

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ Saitz, *supra* note 51.

⁵⁷ FBI, *Operation Quick Flip*, *supra* note 8.

⁵⁸ See Mark Morris, *Mortgage Fraud’s New Super Sleuths*, KANSAS CITY STAR, Jan. 14, 2007, at A1.

⁵⁹ *Id.*

Buyer

1. Attorney
2. Title Abstractor
3. Title Company
4. Home Inspector or Engineer
5. Mortgage Broker
6. Mortgage Company
7. Real Estate Broker
8. Appraiser

The buyer can be a “straw buyer,” an innocent individual who may be duped into buying overpriced properties.⁶⁰ The “straw buyer” can be innocent individuals who have had their identities stolen, or less sophisticated individuals such as first time home purchasers or recent immigrants.⁶¹ Other times, the “straw buyer” is a knowing participant in the flipping scheme. There are two typical “straw buyer” scenarios:

Straw Buyer Used for Profit Equity Skimming: The “straw buyer” obtains a high LTV (loan to value) loan to purchase the property, “so very little cash is invested in the property.”⁶² The “straw buyer” does not make any mortgage payments, allowing the property to go into foreclosure.⁶³ The “straw buyer” then “rents the property and keeps the rental income from the property until the property is foreclosed.”⁶⁴

Straw Buyer used to Purchase a Property: “Straw buyer,” whose “credit is normally sufficient to qualify,” is “paid to purchase the property for a third party.”⁶⁵ The third party typically manages/rents/lives in the property as their own while the “straw buyer” usually will have no further involvement after the purchase or

refinance.⁶⁶ The “straw buyer” may quit-claim the property to the third party after the closing.⁶⁷

There are various hints to indicate when a straw buyer may be used:

- 1) Down payment check is drawn on an account different from that shown on the loan application;
- 2) Names are added to purchase contract;
- 3) HUD-1 indicates transfers or payments to brokers or third parties;
- 4) Quit Claim Deed is used either right before or soon after closing;
- 5) The sale is to a relative or related party;
- 6) There is little or no credit for borrower;
- 7) There is usually a lack of substantiated down payment through the closing; and
- 8) There may be no real estate agent.⁶⁸

Bank/Mortgage Company/Mortgage/Broker

1. Attorney
2. Mortgage Broker
3. Mortgage Company
4. Loan Processors
5. Appraisers

While various flipping schemes may employ any variety of these parties/individuals in the conspiracy, it appears that attorneys and/or appraisers are often key players to a successful flipping scheme. However, a number of innocent attorneys may be subjected to various claims simply because the attorneys were not fully informed of the transaction details or failed to notice certain discrepancies in the various agreements. A majority of real estate fraud occurs in residential transactions because sellers and buyers are

⁶⁰ Laura Tierney, *Truth is Stranger than Fiction: Tales from the Title Trenches*, PRACTICNG L. INST. REAL ESTATE L. & PRACTICE, 8708 PLI/Real 75, 89 (Jan-Mar. 2006).

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ Tierney, *supra* note at 60, at 89.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ *Id.* at 90.

typically less sophisticated, parties are less likely to be represented by counsel, and lenders and closers have a large volume of residential loans and closings.

In those illegal property flip schemes involving an appraiser, the “appraiser acts in collusion with a borrower and provides a misleading appraisal report to the lender” by inflating the value of a property or falsely reporting houses on otherwise vacant property.⁶⁹ An appraisal can be inflated by using comparables that are superior to the property in question, failing to disclose prior sales, or listing improvements that have not been made.⁷⁰

III. OBLIGATION OF EACH PARTY

1. Obligations of persons listed under Seller’s side to Seller.
 - a. Obligations of parties listed on Seller’s side, if any, to Buyer or Bank.
2. Obligations of parties listed under Buyer’s side to the Buyer and to the Seller or Bank.

Insured closing letters, also known as closing protection letters, “were developed in response to lenders expanding beyond state and regional boundaries.”⁷¹ “A closing protection letter is an agreement by a title insurance company to indemnify a lender, or in some cases a purchaser, for losses caused by a settlement agent’s fraud or dishonesty or by the agent’s failure to follow the lender’s written closing instructions.”⁷² In most states, closing protection letters have “become standard in mortgage loan closings conducted by anyone other than a title insurance company.”⁷³ In fact, a number of “state insurance commissioners have taken the

position that closing protection letters are insurance”⁷⁴ Thus, those states have “either regulated the type of closing protection letters a title insurer may provide” or, in some situations, “prohibited closing protection letters altogether.”⁷⁵

However, other courts and state insurance departments have concluded that closing protection letters are not insurance.⁷⁶

A majority of courts have held that if a title insurance company has not issued a closing protection letter, the title insurer has

⁷⁴ *Id.*

⁷⁵ Tierney, *supra* note 60 at 87.

⁷⁶ JOYCE PALOMAR, *Title Insurers’ Liability for Escrow and Closing Services*, TITLE INSURANCE LAW §20:15 (Oct. 2007); *see, e.g.*, *Escrow Disbursement Ins. Agency, Inc. v. Am. Title & Ins. Co., Inc.*, 550 F. Supp. 1192, 1197 (S.D. Fla. 1982) (closing protection letters do not spread risk, which is a defining characteristic of insurance under the McCarran-Ferguson Act); *Metmor Fin., Inc. v. Commonwealth Land Title Ins. Co.*, 645 So. 2d 295, 297 (Ala. 1993) (closing protection letter did not fit state’s statutory definition of title insurance because it did not insure “against loss by encumbrance, or defective titles, or invalidity or adverse claim to title” (citing ALA. CODE §27-5-10(1975))); *but see* FLA. STAT. § 627.786 (2007); TEX. INS. CODE ANN. § 9.49 (Vernon 2007); *Fleet Mortgage Corp. v. Lynts*, 885 F. Supp. 1187, 1190 (E.D. Wis. 1995) (“It is apparent that the general perception of the closing protection letters within the industry is that they are related to the issuance of the title insurance policy and are not a separate, unrelated service.”); *Sears Mortgage Corp. v. Rose*, 634 A.2d 74, 86-87 (N.J. 1993) (closing protection letter is part and parcel of title insurance policy); *Clients’ Sec. Fund of the Bar of N.J. v. Sec. Title and Guar. Co.*, 634 A.2d 90, 93 (N.J. 1993) (noting Southern Mortgage Associates “also required a ‘closing-protection letter’ from the title-insurance company. The letter protected SMA against the risk of loss resulting from the fraud or theft of the buyer’s closing attorney, who was designated as the title company’s ‘approved attorney’ for the purposes of the closing. Alliance did not charge SMA for the protection afforded through the letter; rather, the cost of that protection was built into the insurance premium charged and paid for by Hart.”); and, *Lawyers Title Ins. Corp. v. Edmar Const. Co., Inc.*, 294 A.2d 865 (D.C. 1972).

⁶⁹ *Id.* at 87.

⁷⁰ Tierney, *supra* note at 60, at 87.

⁷¹ *Id.* at 87.

⁷² *Id.*

⁷³ *Id.*

no liability for fraud or other misconduct by a settlement agent in connection with the closing.⁷⁷ Unless the lender's loss is protected by some provision of a title insurance policy or by a particular statute, the lender (not the title insurer) bears the risk of loss caused by a settlement agent/attorney's misconduct.⁷⁸

3. Obligations of parties listed under Bank's side to the Bank, the Buyer and/or Seller Bank.

IV. TYPES OF CLAIMS

There are a variety of claims that can arise from flipping schemes. Those claims include:

1. Negligence
2. Consumer Fraud
3. Common Law Fraud
4. Violation of the Real Estate Settlement Procedures Act ("RESPA")
5. Civil Conspiracy
6. Negligent Misrepresentation
7. State and Federal RICO claims
8. Criminal Responsibility
9. Truth in Lending Act Violations
10. Discrimination under the Fair Housing Act

In order to effectuate the flipping, parties may use one of the following schemes, which often serve as the basis for Consumer Fraud, Common Law Fraud and Negligent Misrepresentation claims:

Backward Applications: After identifying a property to purchase, a borrower customizes his/her income to meet the loan criteria.

Air Loans: These are non-existent property loans where there is usually no collateral. An example would be where a broker invents borrowers and

properties, establishes accounts for payments and maintains custodial accounts for escrows. They may set up an office with a bank of telephones, each one used as the employer, appraiser, credit agency, etc. for verification purposes.

Silent Seconds: The buyer of a property borrows the down payment from the seller through the issuance of a non-disclosed second mortgage. The primary lender believes the borrower has invested his own money in the down payment, when in fact, it is borrowed. The second mortgage may not be recorded to further conceal its status from the primary lender.

Nominee Loans: The identity of the borrower is concealed through the use of a nominee who allows the borrower to use the nominee's name and credit history to apply for a loan.

Foreclosure schemes: The subject identifies homeowners who are at risk of defaulting on loans or whose houses are already in foreclosure. Subjects mislead the homeowners into believing that they can save their homes in exchange for a transfer of the deed and up-front fees. The subject profits from these schemes by re-mortgaging the property or pocketing the fees paid by the homeowner.

Equity Skimming: An investor may use a straw buyer, false income documents, and false credit reports to obtain a mortgage loan in the straw buyer's name. Subsequent to closing, the straw buyer signs the property over to the investor in a quit claim deed which relinquishes all rights to the property and provides no guaranty to title. The investor does not make any mortgage payments and rents the property until foreclosure takes place several months later.⁷⁹

⁷⁷ See PALOMAR, *supra* note 76.

⁷⁸ See *id.*

⁷⁹ FBI, *Operation Quick Flip*, *supra* note 8.

In an attempt to prevent illegal property flips, HUD adopted a new rule in 2003 by placing time restrictions on re-sales.⁸⁰ Under this rule, re-sales occurring ninety (90) days or less following acquisition are not eligible for a mortgage to be insured by FHA.⁸¹ Re-sales occurring between 91 and 180 days will be eligible provided that the lender obtains an additional appraisal from an independent appraiser based on a re-sale percentage threshold established by the FHA.⁸²

RESPA⁸³

Congress enacted the Real Estate Settlement Procedures Act⁸⁴ (“RESPA”) in 1974 to change the settlement process for residential real estate to require “more effective advance disclosure to home buyers and sellers of settlement costs” and to eliminate “kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services.”⁸⁵

Professional liability plaintiffs now frequently include “RESPA violation” allegations within Complaints alleging improper real estate flipping against professionals. Although defendants may cite to traditional pleading requirements in defending themselves - arguing that plaintiffs have not plead and/or cannot demonstrate a viable fraud or negligence claim - the mere appearance of a RESPA violation will, at the very least, enhance plaintiffs’ claims, and at worst, conclusively establish the same.

HUD is responsible for enforcing RESPA.⁸⁶ The RESPA statute is implemented and interpreted by HUD’s “Regulation X”⁸⁷ and HUD policy

statements.⁸⁸ RESPA covers transactions involving a “federally related mortgage loan”, which includes most loans secured by a lien (first or subordinate position) on residential property.⁸⁹ This includes: home purchase loans, refinances, lender approved assumptions, property improvement loans, equity lines of credit, and reverse mortgages.⁹⁰

The following kinds of transactions are *not* covered by RESPA: (1) all-cash sales; (2) sales where the individual home seller takes back the mortgage; (3) rental property transactions; (4) business-purpose transactions.⁹¹

Disclosures Under RESPA

A. Application Disclosure

When a borrower applies for a mortgage loan, RESPA requires the mortgage broker and/or lender to give the borrower (or mail to the borrower within 3 business days of receiving the loan application): (1) a Special Information Booklet, which contains consumer information about various real estate settlement services (this is required only for purchase transactions); (2) a Good Faith Estimate (GFE) of settlement costs, listing charges the borrower is likely to pay at settlement; and (3) a Mortgage Servicing Disclosure Statement, which discloses to the borrower whether the lender intends to service the loan or transfer it to another lender.⁹²

⁸⁰ See 24 C.F.R. § 203 (2008).

⁸¹ See 24 C.F.R. § 203.37a(b)(2).

⁸² See 24 C.F.R. § 203.37a(b)(3).

⁸³ This section on RESPA was prepared by Andrew R. Jones, Esq., New York, New York.

⁸⁴ See 12 U.S.C. § 2601(b)(1)-(2) (2008).

⁸⁵ *Id.*

⁸⁶ See 12 U.S.C. § 2617 (2008).

⁸⁷ 24 C.F.R. § 3500 (2008).

⁸⁸ Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, 64 Fed. Reg. 10080 (Mar. 1, 1999).

⁸⁹ 12 U.S.C. § 2602(1)(a) (2008); 24 C.F.R. § 3500.2.

⁹⁰ See 24 C.F.R. §§ 3500.2, 3500.6(5).

⁹¹ 12 U.S.C. § 2606; 24 C.F.R. § 3500.5

⁹² See 12 U.S.C. § 2604(a)-(d), 2605; *see also* 24 C.F.R. §§ 3500.6(a)-3500.7.

B. Pre-Closing Disclosure

When a settlement service provider involved in a RESPA-covered transaction refers a consumer to another provider with whom the referring provider has an ownership or other beneficial interest, the referring provider must give the consumer (at or prior to the time of the referral) an “Affiliated Business Arrangement Disclosure,” describing the business arrangement between the two providers and giving an estimate of the second provider’s charges.⁹³ The referring party may not require the consumer to use the particular provider being referred except where a lender refers a borrower to an attorney, credit reporting agency, or real estate appraiser who represents the lender’s interest in the transaction.⁹⁴

A HUD-1 Settlement Statement is a standard form that shows “all charges imposed” on the borrower and seller “in connection with the settlement”⁹⁵ RESPA allows a borrower to request to see the HUD-1 settlement statement one day before the actual settlement.⁹⁶ The settlement agent must then provide the borrower with a completed HUD-1 Settlement Statement based on information known to the agent at the time.⁹⁷

C. Closing Disclosures

RESPA requires that the borrower and seller be provided with a settlement statement at closing (or if the party does not attend closing, that the form be delivered as soon as practicable after closing).⁹⁸

At settlement (closing), or within 45 days, RESPA requires the lender to provide

an Initial Escrow Statement.⁹⁹ The Initial Escrow Statement “itemize[s] the estimated taxes, insurance premiums, and other charges” anticipated to be paid from the escrow account during the first twelve months of the loan and lists the escrow payment amount and any required cushion (which may not exceed an amount equal to 1/6 of the total projected disbursements for the year).¹⁰⁰

D. Post-Closing Disclosures

RESPA requires the loan servicer (bank) to deliver an Annual Escrow Statement once each year.¹⁰¹ The Annual Escrow Statement summarizes all escrow account deposits and payments during the servicer’s twelve-month computation year.¹⁰² It also notifies the borrower of any shortages or surpluses in the account and advises the borrower about the course of action being taken.¹⁰³ Any surplus of \$50 or more must be returned to the borrower.¹⁰⁴

If the loan servicer sells or assigns the servicing rights to the borrower’s loan to another loan servicer, RESPA requires the loan servicer to notify the borrower “not less than 15 days before the effective date” of the loan transfer.¹⁰⁵ The Servicing Transfer Statement must include the name and address of the new servicer, toll-free telephone numbers, and the date the new servicer will begin accepting payments (as long as the borrower makes a timely payment to the old servicer within 60 days

⁹³ See 12 U.S.C. § 2602(7); 24 CFR § 3500.15(b).

⁹⁴ See 24 C.F.R. § 3500.15(b)(2).

⁹⁵ 12 U.S.C. § 2603(a); see also the HUD-1 Settlement Statement sample, attached as Exhibit A.

⁹⁶ See 12 U.S.C. § 2603(b); 24 C.F.R. § 3500.10(a).

⁹⁷ 12 U.S.C. § 2603(b); 24 C.F.R. § 3500.10(b).

⁹⁸ See 12 U.S.C. § 2603(b); 24 C.F.R. §§ 3500.8(a), 3500.10(b)-(c).

⁹⁹ See 12 U.S.C. § 2609(c)(1); 24 C.F.R. §§ 3500.17(g), 3500.10(b)-(c).

¹⁰⁰ See 12 U.S.C. § 2609(a)(1); 24 C.F.R. § 3500.17(c), (g).

¹⁰¹ See 12 U.S.C. §§ 2605(i), 2609(c)(2); 24 C.F.R. § 3500.17(i).

¹⁰² See 12 U.S.C. § 2609(c)(2); 24 C.F.R. § 3500.17(i)(1).

¹⁰³ 24 C.F.R. § 3500.17(i)(1)(vi)-(vii).

¹⁰⁴ See *id.* § 3500.17(f)(2).

¹⁰⁵ 12 U.S.C. § 2605(b)(1)-(2); 24 C.F.R. § 3500.21(d)(1)-(2).

of the loan transfer, the borrower cannot be penalized).¹⁰⁶

Kickbacks and Referral Fees under RESPA

A. Rules Prohibiting

Section 8 of RESPA prohibits anyone from giving or accepting any fee, kickback, or other thing of value in connection with an agreement or understanding that business will be referred to any person.¹⁰⁷ Section 8 also prohibits anyone from giving or accepting any portion, split, or percentage “of any charge made or received for the rendering of a real estate settlement service . . . other than for services actually performed.”¹⁰⁸

B. Rules Permitting Compensation For Settlement Services

RESPA also provides that Section Eight should not be construed as prohibiting “the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or services actually performed”¹⁰⁹

Penalties for Violating RESPA

Violations of RESPA’s Section Eight anti-kickback, referral fees, and unearned fees provisions are subject to criminal and civil penalties.¹¹⁰ In a criminal case a person who violates Section 8 may be fined up to \$10,000 and imprisoned up to one year.¹¹¹ In a private lawsuit a person who violates Section Eight may be liable to the

person charged for the settlement service “an amount equal to three times the amount of any charge paid” for the service.¹¹²

V. DEFENSES TO CLAIMS

Privity:¹¹³ A plaintiff asserting that they were the victim of an illegal real estate flipping scheme frequently includes everyone involved in the closing as a defendant, regardless of what role each individual played in the transaction. Often, these plaintiffs may name the other attorney as a defendant in the litigation based on claims of third party liability. While certain jurisdictions, such as New Jersey, allow claims against attorneys absent privity¹¹⁴, other jurisdictions, such as New York, only impose liability on professionals for their communications with third-parties with whom they are not in privity where they have a special relationship with the third-party that “approach[es] that of privity.”¹¹⁵ However, New York courts have construed this “special relationship” exception narrowly.¹¹⁶

Even in the limited circumstances where privity can be established despite the lack of direct contractual privity, New York courts have imposed strict requirements, such as: (a) the attorney be aware that his statement(s) are made “for a particular purpose;” (b) a known third-party relies “on the statement in furtherance of that purpose;” and (c) there exists additional conduct by the attorney linking the statement to the relying party which

¹⁰⁶ See 12 U.S.C. § 2605(b)(3), (d); 24 C.F.R. § 3500.21(d)(3), (5).

¹⁰⁷ See 12 U.S.C. § 2607(a); 24 C.F.R. § 3500.14(a)-(b).

¹⁰⁸ 12 U.S.C. § 2607(b); 24 C.F.R. § 3500.14(c).

¹⁰⁹ 12 U.S.C. § 2607(c); 24 C.F.R. § 3500.14(g)(iv).

¹¹⁰ See 12 U.S.C. § 2607(d); see also 24 C.F.R. § 3500.19(b).

¹¹¹ 12 U.S.C. § 2607(d)(1).

¹¹² 12 U.S.C. § 2607(d)(2).

¹¹³ This section on privity was created using written materials prepared by Andrew R. Jones, Esq., New York, New York.

¹¹⁴ *Petrillo v. Bachenberg*, 655 A.2d 1354, 1360-61 (N.J. 1995) (court imposing liability on an attorney to a non-client where the attorney should know that the non-client would rely on the attorney’s actions).

¹¹⁵ See *Prudential Ins. Co. of Am. v. Dewey*, Ballantine, Bushby, Palmer & Wood, 605 N.E.2d 318, 320 (N.Y. 1992).

¹¹⁶ See *Ossining Union Free Sch. Dist. v. Anderson LaRocca*, 539 N.E.2d 91, 95 (N.Y. 1989).

demonstrates that reliance.¹¹⁷

In *Wei Cheng Chang v. Pi*,¹¹⁸ New York Appellate Division Second Department held that the lower court erred in determining that the plaintiffs had retained the defendant attorney to represent them in the underlying land purchase deal.¹¹⁹ On November 11, 1988, the plaintiff/purchasers “entered into a contract to purchase certain parcels of land from the [defendant/sellers].”¹²⁰ “It [was] undisputed that the [defendant/attorneys] represented the [defendant/sellers] in the transaction.”¹²¹ The trial court found that the defendant attorneys also represented both the plaintiff purchasers and the sellers and “committed malpractice by drafting a contract with terms which were overly favorable to the sellers.”¹²² The trial court placed weight upon the fact that the “application for title insurance and [several] letters from the [defendant/attorneys] to the attorneys for the mortgagor and to a title insurance company identified the [defendant/attorneys] as attorneys for the plaintiffs.”¹²³

In reversing, the New York Appellate Division held that “no attorney-client relationship was created” with the plaintiff/purchasers and noted that: (1) the documents at issue were prepared long “after the contracts for the purchase of the subject parcels were executed;” (2) the record was “devoid of any written or oral agreement that the [defendant/attorneys] would perform a specific task for the [plaintiff/purchasers] with respect to their purchase” of the premises; (3) the [defendant/attorney] was “not even present in the room when the [plaintiffs] discussed

and reviewed contract terms, and subsequently executed the contracts;” and (4) there was “no agreement to pay a fee to the [defendant/attorneys], and no fee was ever paid or demanded.”¹²⁴ Since the New York Appellate Division held that “no attorney-client relationship existed” between the plaintiffs and the defendant attorneys, the “plaintiffs’ claim for legal malpractice [was] dismissed.”¹²⁵

If a plaintiff in a flipping scheme action alleging negligence against an attorney does not properly allege that any duty arose from a relationship of privity (the defendant/attorney did not represent plaintiff; plaintiff did not pay fees to the defendant/attorney; nor did the defendant/attorney and plaintiff have any relationship, much less a special relationship “approaching privity”) then dismissal may be warranted, depending on the jurisdiction.

It may also be helpful to use the language found in various closing documents to prove that the plaintiff could have been deceived or misled by the professionals’ alleged misrepresentations. For example:

Sample Deposition Approach

[Mark HUD-1 Settlement Statement as an Exhibit for identification]

Q. We’ve just marked Defendant’s Exhibit A which is a two page document. I’ll represent to you [plaintiff] that this was produced by your counsel and that it is called a HUD-1 settlement statement. Is that your signature at the bottom of the form?

A. Yes, that’s my signature.

Q. Do you remember ever seeing this document before?

A. No.

¹¹⁷ *Prudential*, 605 N.E.2d at 321-22; see also *Cal. Employees’ Ret. Sys. v. Shearman & Sterling*, 741 N.E.2d 101, 104 (N.Y. 2000); *Credit Alliance Corp. v. Arthur Andersen & Co.*, 483 N.E.2d 110, 118 (N.Y. 1985).

¹¹⁸ *Wei Cheng Chang v. Pi*, 288 A.2d 378 (N.Y. App. Div. 2001).

¹¹⁹ *Id.* at 380.

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² *Id.*

¹²³ *Wei Cheng Chang*, 288 A.2d at 380-81.

¹²⁴ *Id.*

¹²⁵ *Id.*

Q. Do you remember seeing it at the closing?

A. Oh, yes. I'm not entirely sure though.

Q. I'll represent to you that the bottom of page two, just above your signature, says as follows: *I have carefully reviewed the HUD-1 settlement statement and to the best of my knowledge and belief it is a true and accurate statement of all receipts and disbursements made on my account or by me in this transaction. I further certify that I have received a copy of the HUD-1 settlement statement.* Does that refresh your memory as to whether you ever saw this document before?

A. Yeah, I saw that, I read that.

Q. I would like to also show you the first page of the exhibit where it says cash at settlement and line 300 says cash from borrower \$80,000. Did you ever bring \$80,000 to the closing?

A. No. I said before, I didn't have \$800 dollars to bring to the closing.

Q. *Do you know why it says that you brought the \$80,000 to the closing?*

A. No.

Q. Did you bring \$80,000 to the closing?

A. No.

Q. Then why did you represent that you had carefully reviewed the HUD form and it was accurate?

A. I don't know.

Lack of Damages: Plaintiffs may have difficulty proving their claim if the value of the property, despite being part of a real estate flipping scheme, has increased in value.

Conspiracy Claims:¹²⁶ While some jurisdictions recognize the independent tort of civil conspiracy¹²⁷ other jurisdictions,

¹²⁶ This section on conspiracy claims was created using written materials prepared by Andrew R. Jones, Esq., New York, New York.

¹²⁷ See *Weil v. Express Container Corp.*, 824 A.2d 174, 183 (N.J. App. Div. 2003).

such as New York, does not.¹²⁸ Such a cause of action is available only if there is evidence of an underlying actionable tort to connect the actions of separate defendants with an otherwise actionable tort.¹²⁹ Therefore, it may be possible to move to dismiss a civil conspiracy claim for failure to state a cause of action.

VI. CASE LAW

Examples of flipping

*United States v. Agboola*¹³⁰

[Defendant,] a Nigerian citizen, owned a mortgage brokerage company called Mortgage Advancement Corporation ("MAC"), and two other companies called AG Properties ("AG") and AGM Investment Corporation ("AGM"). MAC provided mortgage brokering and other real estate services. From 1997 to 2001, Agboola and his brother-in-law, Michael Aihe ("Aihe"), were involved in a property "flipping" scheme where certain property values were inflated through fraudulent appraisals provided by Aihe's company, Lakeland Appraisals. Agboola purchased properties through AG and AGM, then resold them to MAC clients, in order to inflate the apparent value of the properties and generate fraudulently obtained proceeds. The transactions MAC brokered used false seller carry-back promissory notes, fraudulent down payments, and other false documents and devices. These practices permitted MAC, AG, and AGM to obtain loan proceeds exceeding the actual market value of the real estate.

¹²⁸ See *Guglielmo v. Unanue*, 244 A.D.2d 718, 721 (N.Y. App. Div. 1997); *Factory Point Nat'l. Bank v. Wooden Indian, Inc.*, 198 A.D.2d 563, 565 (N.Y. App. Div. 1993).

¹²⁹ See *Factory Point*, 198 A.D.2d at 565; see also *Danahy v. Meese*, 84 A.D.2d 670, 672 (N.Y. App. Div. 1981).

¹³⁰ *United States v. Agboola*, No. 01-162 (JRT/FLN), 2006 WL 2521624 (D.Minn. Aug. 30, 2006).

AG and AGM would hold title to real estate for as little as one day before selling to a MAC client for substantially higher prices, based on the fraudulent appraisals. Agboola encouraged MAC employees to set up their own companies to purchase and sell real estate, as well as use “seller carry-back” loans to pay off a client's down payment to help the client qualify for a mortgage. Agboola provided the funds for these transactions. The normal practice at MAC was to forgive the carry-back loans so clients would not have to repay them, but institutional lenders were not informed of the practice. Agboola also directed MAC employees to submit fraudulent loan documents, deposit verifications, employment records, income records, and tax returns to mislead lenders into funding transactions MAC brokered.¹³¹

The court “found the loss to others from Agboola's property flipping scheme and bankruptcy fraud totaled \$738,498.”¹³²

*United States v. Haehle*¹³³

Defendant's property flipping scheme “took place in the City of Milwaukee.”¹³⁴ The defendant, Haehle, would purchase inner-city properties “at a very low price.”¹³⁵ “Then he would sell the property to a straw buyer at an inflated price. Using the straw buyer, the inflated price, and a fictional down payment, Haehle would convince a target bank to loan the straw purchaser the remaining balance due.”¹³⁶ The proceeds from the loan would “first go through Haehle's loan brokering corporation.”¹³⁷ Thereafter, “Haehle and the straw buyer would split up the proceeds.”¹³⁸ The scheme fell apart when

“the City of Milwaukee eventually condemned” the properties because no one was improving the properties, thereby “causing approximately 62 parcels to wind up in receiverships.”¹³⁹

Attorney & Flipping Schemes

*First Bancorp Mortgage Corp. v. Giddens*¹⁴⁰

Plaintiff, a mortgage corporation, brought a legal malpractice action against the closing attorney and law firm in connection with the flipping sales of property which resulted in the corporation have to pay foreclosure losses.¹⁴¹

In October 1996 and November 1996, Bancorp entered into two residential real estate transactions in Atlanta with Louie B. and Doreen Golden and Timothy Aiken, respectively. Shortly thereafter, both the Golden and Aiken defaulted on their loans. Despite selling both mortgages to another company, Bancorp retained an obligation to pay foreclosure losses occurring in the first 12 months. Richard Arms, the president of Bancorp, described both transactions as being what he termed “flip sales.” Arms testified that Bancorp would not have made either loan if he had known they were “flips” and said Bancorp's combined losses were in excess of \$78,000. Arms testified that he absolutely would have expected to be notified of the “flip sales” if his own lawyer had closed both loans. . . .

The crux of Bancorp's complaint was that because [Bobby L.] Giddens [and his law firm] had been the closing attorney for both prior sales, he knew, or in the exercise of ordinary care should have known, that the value of the premises was far below the amount of the loan being closed. . . . In the malpractice affidavit accompanying the complaint, Bancorp's expert, William E. Duncan, testified that due care requires the

¹³¹ *Agboola*, 2006 WL 2521624, at *1.

¹³² *Id.* at *2.

¹³³ *United States v. Haehle*, 227 F.3d 857 (7th Cir. 2000).

¹³⁴ *Id.* at 858.

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ *Id.*

¹³⁸ *Haehle*, 227 F.2d at 858.

¹³⁹ *Id.*

¹⁴⁰ *First Bancorp v. Giddens*, 555 S.E.2d 53 (Ga. Ct. App. 2001).

¹⁴¹ *Id.* at 676.

lender's closing attorney to “notify the lender of any discrepancy, abnormality or irregularity.” At trial, Duncan testified that when a flip transaction occurs that the closing attorney knows about, then that attorney has a duty to inform the lender and “let them re-evaluate the risk of making a loan.” He testified that Bancorp should have been told about the substantial increases in the sales price of the same property sold within a short time period. In Duncan’s expert opinion, because Giddens had conducted the closings, Giddens was negligent for failing to notify Bancorp that the property securing the loan to the Goldens sold for \$17,000 then \$65,075 within 15 days and that the property securing the loan to Aiken sold for \$30,000 then \$77,500 a day later. According to Duncan, a flip transaction puts a person on notice that something may be wrong. But he also conceded that there may occasionally be legitimate reasons for these types of transactions.

Defense expert Pickens Andrew Patterson, Jr. disagreed with Duncan. Patterson testified that the primary responsibilities of a closing attorney are to ensure that good title can be conveyed and that the lender obtains the desired mortgage position. Patterson explained that a closing attorney must follow the written instructions provided by the mortgage lender “to the ‘t’.” In his view, a closing attorney does not have a duty to advise of prior sales unless the closing instructions require him to do so. Patterson reviewed both loans at issue and, in his opinion, Giddens followed generally accepted standards of care applicable to attorneys acting under the same or similar circumstances. In Patterson’s expert opinion, a closing attorney does not have a legal duty or a legal responsibility to disclose recent prior sales involving substantial discrepancies in price but agreed that it would “probably” be the “better practice” to inform the lender about such sales. After the jury found for Giddens and

his law firm, Bancorp appealed.¹⁴²

The Georgia Court of Appeals affirmed the defense verdict.¹⁴³

*In re Lattimore*¹⁴⁴

A South Carolina attorney was disbarred for his conduct in closing 88 residential real estate loans in flipping transactions where mortgage brokers, loan officers, and/or appraisers fraudulently obtained money from lenders by using simultaneous sales at actual value and resales at inflated values, with the attorney having actual notice of inflated appraisals in at least two transaction and having constructive knowledge of fraud in the other transactions.¹⁴⁵ The attorney also allowed members of his staff (non-attorneys) to notarize signatures they had not witnessed and to conduct closings.¹⁴⁶

*In re Lathan and In re Barbare*¹⁴⁷

Unlike the *Lattimore* case, these two innocent attorneys become the scapegoat for greedy property sellers and a corrupt employee for a lender, subjecting Ray Lathan, Esq. and Ronald Barbare, Esq. to federal criminal prosecution, license suspension, and personal exposure to civil claims.¹⁴⁸

On one hand, the various sellers who used Lathan and Barbare’s services made large sums of monies from the schemes. One real estate property seller admitted he had made between \$5,000,000 and \$10,000,000 from the scheme.¹⁴⁹ Another

¹⁴² *Id.* at 676-77.

¹⁴³ *Id.* at 681.

¹⁴⁴ *In re Lattimore*, 604 S.E.2d 369 (S.C. 2004).

¹⁴⁵ *See id.* at 370-72.

¹⁴⁶ *See id.*

¹⁴⁷ *In re Lathan*, 600 S.E.2d 902 (S.C. 2004); *In re Barbare*, 602 S.E.2d 382 (S.C. 2004); *see also* John Freeman, *Ethics Watch: HUDI Misery*, 16 S.C.LAW. 7 (2001).

¹⁴⁸ *See generally Lathan*, 600 S.E.2d at 903-908; *Barbare*, 602 S.E.2d at 382-388.

¹⁴⁹ *Lathan*, 600 S.E.2d at 905; *Barbare*, 602 S.E.2d at 384.

property seller who used the lawyers' legal services admitted to receiving \$3,075,000 from the various real estate schemes.¹⁵⁰ Another defendant, a corrupt employee for a lender admitted obtaining between \$1,500,000 and \$2,500,000 from the scheme.¹⁵¹

On the other hand, the investigation revealed that the attorneys “did not receive any special financial benefit from the closings” while all fees received are shown on the Firm's trust account ledger appeared “to be reasonable and customary for work of this type. . . .”¹⁵² Further, there was no allegation either lawyer “deliberately sought to assist [others] in criminal undertakings or had knowledge of their criminal intent.”¹⁵³ Nevertheless, the lawyers ended up paying hundreds of thousands of dollars to settle claims brought by various buyers and lenders.¹⁵⁴

The lawyers' downfall was not due to greed, but rather inaccurate HUD-1 statements.¹⁵⁵ Specifically, the lawyers' problems stemmed from recording closings using two sets of books. One set, the HUD-1 statements, indicated “substantial investments in property by the buyers.”¹⁵⁶ Line 303 of the HUD-1, reflecting the sum of money provided from borrowers' pockets, was inflated and false. The South Carolina Supreme Court noted that the information stated in line 303 was false because the borrower's contribution was either nonexistent or fraudulently

inflated.^{157 158} A lawyer who transmits a HUD-1 showing an inflated equity cushion has generated a fraudulent document. A federal statute criminalizes publication of false HUD-1 statements.¹⁵⁹

In addition, missing from the HUD-1 statements was the notation POC (“paid outside closing”) across from line 303 indicating that the buyer's alleged payment had not passed through the closing lawyer's hands.¹⁶⁰ Without the POC notation, anyone reviewing the lenders' HUD-1 statement would have been misled into believing that all the funds had passed through the lawyer's trust account at the closing.¹⁶¹ The lawyers' problems were further compounded by their own internal financial paperwork on the transactions that presented facts different from those shown on the HUD-1 statement delivered to lenders.¹⁶² For example, in two cases, the lawyers' “internal reports, but not the lenders' HUD-1s, reflected cash paid outside the closing supposedly by the borrowers, but coming in the form of checks drawn on the seller's account.”¹⁶³ This omission casts doubt on the legitimacy of the selling price for the piece of property against which the lender was making the loan.¹⁶⁴

The South Carolina Supreme Court was disappointed by the lawyers' conduct and, worse, by evidence suggesting that the lawyers' behavior was not unusual for lawyers handling residential real estate closings in South Carolina. The South

¹⁵⁰ *Lathan*, 600 S.E.2d at 907; *Barbare*, 602 S.E.2d at 387.

¹⁵¹ *Lathan*, 600 S.E.2d at 907; *Barbare*, 602 S.E.2d at 387.

¹⁵² *Lathan*, 600 S.E.2d at 907; *Barbare*, 602 S.E.2d at 387.

¹⁵³ *Lathan*, 600 S.E.2d at 907-08; *Barbare*, 602 S.E.2d at 387.

¹⁵⁴ *See Lathan*, 600 S.E.2d at 907; *Barbare*, 602 S.E.2d at 387.

¹⁵⁵ *Lathan*, 600 S.E.2d at 904-07; *Barbare*, 602 S.E.2d at 382-88.

¹⁵⁶ *Freeman*, *supra* note 147, at 8; *accord Lathan*, 600 S.E.2d at 905; *Barbare*, 602 S.E.2d at 384.

¹⁵⁷ For ease of reference, a sample HUD-1 statement is attached hereto as Exhibit A.

¹⁵⁸ *See Lathan*, 600 S.E.2d at 905; *Barbare*, 602 S.E.2d at 384; *see also Freeman*, *supra* note 147, at 8.

¹⁵⁹ *See* 18 U.S.C. § 1010.

¹⁶⁰ *See Lathan*, 600 S.E.2d at 904; *Barbare*, 602 S.E.2d at 384; *see also Freeman*, *supra* note 147, at 8.

¹⁶¹ *Freeman*, *supra* note 147, at 8.

¹⁶² *Id.*

¹⁶³ *Freeman*, *supra* note 147, at 8; *accord Lathan*, 600 S.E.2d at 906-07; *Barbare*, 602 S.E.2d at 385-387.

¹⁶⁴ *Freeman*, *supra* note 147, at 8.

Carolina Supreme Court stated:

According to the parties in this matter, a large number of attorneys are not passing closing funds through their trust accounts and, at the same time, not identifying the funds as paid outside of closing on closing documents. Not only does this practice fail to accurately record the actual transaction for the buyer and seller, but it is misleading to lenders. In an attempt to eliminate this and other deceptive practices, we emphasize that costs and credits in connection with a real estate transaction must be shown on the settlement statement and that the settlement statement must reflect all amounts paid, by whom paid, and to whom paid. Any charges or amounts paid outside of the closing must be reflected as such on the settlement statement. For all funds exchanged during the closing, the attorney must have a record of the method of payment by the parties to the transaction, as well as an accounting of all receipts and disbursements by the attorney. The attorney's records must accurately reflect the transaction as evidenced by the settlement statement unless there is written documentation signed by all parties to the transaction (including any lender) indicating that funds were disbursed otherwise. Failure to comply with these standards may subject attorneys to disciplinary action.¹⁶⁵

The South Carolina Supreme Court's ruling mandated that:

1) Payments by the borrower outside of closing, whether covered by line 303, or line 201 which covers ("deposit or earnest money" payments) must either be received and disbursed by the settlement agent, or retained by the real estate agent and disclosed

appropriately on the HUD-1 or marked POC on the HUD-1;

2) If an internal addendum is used to reflect special facts modifying a transaction, then copies of the modifying addendum need to be delivered to the lender;

3) If property is being "flipped," that is, bought and immediately resold with the proceeds of the second transaction being used to fund the first transaction, then the true facts concerning the second transaction need to be disclosed so that the lender in the second transaction can see that the proceeds of the loan are being used to fund the first transaction. One way of making this disclosure is by using the blank lines from 204 to 209 and from 513 to 519 to make the economic reality of the transaction obvious to the lender (and possibly, the purchaser) who gets the HUD-1 on the second transaction; and

4) The HUD-1 needs to reflect the material dealings between the borrower and the lender. Funds listed on the HUD-1 which do not pass through the lawyer's hands must be marked POC. However, a variance between amounts shown on lines 303 and 603 and the cash amounts disbursed from the lawyer's trust account can be indicative of deception.¹⁶⁶

*New Jersey v. Harris*¹⁶⁷

Sonia Harris, "an attorney, represented George Shamond Scott (Scott), a real estate developer."¹⁶⁸ Scott was owner and CEO of Ace Management Company (Ace), which he used to flip properties.¹⁶⁹ Scott "contracted to buy property and then sold the property before legally acquiring it.

¹⁶⁵ *Lathan*, 600 S.E.2d at 908-09; *Barbare*, 602 S.E.2d at 388-89; *accord* Freeman, *supra* note 147, at 8.

¹⁶⁶ Freeman, *supra* note 147, at 8-9; *accord* Lathan, 600 S.E.2d at 909; *Barbare*, 602 S.E.2d at 388-89.

¹⁶⁷ *New Jersey v. Harris*, 861 A.2d 165 (N.J. App. Div. 2004).

¹⁶⁸ *Id.* at 167.

¹⁶⁹ *Id.*

Scott also purchased property and acquired multiple mortgages without paying off the existing mortgage.”¹⁷⁰

The “flip” enabled Scott to sell a house before “actually owning a house so he could use the funds in a subsequent purchase.”¹⁷¹ In addition, he paid “Lisa Dumey of Rice Title Agency to falsify title documents to reflect that there were no existing mortgages. Scott paid mortgage brokers to help him secure the mortgages.”¹⁷² Scott also maintained two separate identities, George Scott and Shamond Scott, “to facilitate the fraudulent real estate transactions.”¹⁷³ Scott made almost \$1,000,000 in illegal proceeds from the transactions.¹⁷⁴

Harris acted as the closing attorney in some of these transactions and failed to both “file and record title documents” and to “disclose pre-existing mortgages.”¹⁷⁵ Harris also maintained an attorney trust account for the money derived from the illegal transactions and “drew checks to the order of Scott, to cash, or to another recipient.”¹⁷⁶ Scott paid Harris a total of \$14,000 in legal fees.¹⁷⁷

Harris’s conviction stemmed from:

the purchase, sale, and refinancing of two properties located at 11 East Greenbrook Road and 10 Lakeside Avenue, North Caldwell. In 1999 Scott, through Ace and while represented by [Harris] as his lawyer, entered into a contract to buy a house located at 11 East Greenbrook Road from the Gilligans, represented by Robert Candido, Esq., for \$390,000. After the December 12, 1998 deposit check was returned for insufficient

funds, [Harris] sent a replacement deposit check dated February 9, 1999 to Candido written on [Harris'] attorney trust account for \$18,500. The proposed closing date was April 1, 1999. Over the following months, [Harris] did not respond to any of Candido's numerous attempts to arrange a closing date. On May 5, 1999, Candido wrote a letter to [Harris] terminating negotiations for the sale of the house.

Ace, not disclosing that it did not own the property, sold the house to Robert Arangeo for \$430,000. Scott helped Arangeo obtain a \$300,570 mortgage and told Arangeo that Ace would manage the property for a fee. Scott showed Arangeo and the mortgage company fabricated title work indicating that he purchased the property from the Gilligans. [Harris] prepared the closing documents and represented both Ace and Arangeo at the closing. The proceeds of the sale were deposited into [Harris'] trust account. Arangeo believed that his purchase of the property was an investment and that Ace was managing the property and making the mortgage payments. Arangeo visited the house for the first time approximately one year later, only to discover that the house had been demolished and that he never actually owned the house. At the time of the criminal trial, Arangeo remained obligated to the mortgage company.

On April 14, 1999, after the property was purportedly transferred from Ace to Arangeo, Scott used a falsified title indicating that Ace was the owner of the property to obtain a \$360,000 mortgage. Ace sold the property to George Scott for \$480,000. [Harris] was the closing attorney. On June 2, 1999, the Gilligans, the actual owners, sold the property to a third party for \$422,000. Candido recorded the deed.

¹⁷⁰ *Id.*

¹⁷¹ *Id.*

¹⁷² *Harris*, 861 A.2d at 167.

¹⁷³ *Id.*

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *Harris*, 861 A.2d at 167.

On June 4, 1999 Ace, without ever having owned the property, purportedly sold the house to “Shamond Scott” for \$389,000. [Harris] asked a professional acquaintance, Athena Alsobrook, Esq., to represent Ace at the closing because [Harris] was representing Scott, the buyer. [Harris] told Alsobrook that Ace owned the property, and Alsobrook relied on the representation when reviewing the title certificate. [Harris] prepared the closing statement stating that Ace owned the property. [Harris] represented “Shamond Scott” at the June 4, 1999 closing, notarizing a document used to obtain a \$311,200 mortgage that George Scott signed as “Shamond Scott.” The mortgage company was lead to believe that the mortgage was the first mortgage on the property.

On August 27, 1998, [Harris], on behalf of Ace, entered into a contract of sale with Henry and Roseann Capozzi, represented by Anthony Colasanti, Esq., to purchase a residential property located at 10 Lakeside Avenue, North Caldwell, for \$535,000. On September 30, 1998, Ace, without having title to the property, sold the residence to George Scott for \$725,000. [Harris] prepared the closing statement and obtained the title documents indicating that Ace purchased the property from the Capozzis on January 8, 1998 even though no such sale ever occurred. Scott, using the fraudulent closing documents drafted by [Harris], obtained a \$471,250 mortgage. The mortgage permitted Scott to ultimately purchase the property from the Capozzis.

On October 30, 1998, the Capozzis sold the property to George Scott for \$535,000. [Harris] paid part of the purchase price by writing a \$25,000

deposit check against her attorney trust account. [Harris] was the closing attorney. On December 9, 1998, George Scott obtained a \$100,000 second mortgage.

On June 23, 1999, George Scott purportedly conveyed the property to “Shamond Scott” for \$725,000. [Harris] was the closing attorney. Scott signed the contract for both himself and “Shamond Scott.” “Shamond Scott” sent the mortgage company a title report, signed by [Harris], indicating that he was the owner of the property. Scott obtained a \$580,000 refinance mortgage to pay off the two outstanding mortgages of \$471,250 and \$100,000. [Harris] did not pay off the two mortgages but, instead, deposited the proceeds into her attorney trust account. [Harris] wrote checks on her attorney trust account, at Scott’s direction, for unrelated matters, including a check to Scott for \$400,000. Scott paid [Harris] \$5000 for the closing of the Lakeside Avenue property.¹⁷⁸

Harris was indicted for money laundering for “engaging in a transaction involving property derived from criminal activity with the intent to facilitate or promote the criminal activity.”¹⁷⁹ Harris was subsequently convicted of money laundering and was disbarred.¹⁸⁰

In re NJ Affordable Homes Corp.¹⁸¹

NJ Affordable Homes and its principal, Wayne Puff, are alleged to have spearheaded a global Ponzi scheme to defraud real estate investors. Various defendant attorneys are alleged to have been “retained to represent the Debtor [NJ

¹⁷⁸ *Id.* at 167-69.

¹⁷⁹ *Id.* at 169.

¹⁸⁰ *Id.* at 167.

¹⁸¹ *In re Affordable Homes Corp.*, No. 05-60442 (DHS), 2007 WL 869577 (Bankr. D.N.J. March 19, 2007).

Affordable] in the acquisition and sale of hundreds of parcels of real estate and to represent the Debtor in other matters.”¹⁸² The Trustee’s complaint alleges that the attorneys knew of and/or participated in the Debtor’s scheme. The Trustee seeks compensatory damages, punitive damages and an accounting based upon allegations of legal malpractice, negligence, intentional fraudulent transfers, constructive fraudulent transfers, preferential transfers, and deepening insolvency. At the same time, the defendant attorneys are facing possible criminal indictments.

Closing Protection Letters

*Lawyers Title Insurance Corp. v. New Freedom Mortgage Corp.*¹⁸³

The defendant, a residential mortgage lender brought an action against the title insurer for indemnification under a closing protection letter for losses caused by an alleged sham sale to a straw buyer at an inflated price.¹⁸⁴ To induce the defendant to purchase title insurance, plaintiff issued a closing protection letter.¹⁸⁵

Under the closing protection letter, Lawyers Title agreed:

to indemnify New Freedom under certain circumstances for actual losses New Freedom incurred in connection with residential real estate closings conducted by an agent authorized to issue title insurance on behalf of Lawyers Title (an “issuing agent”). Among other things, the CPL provided that Lawyers Title would reimburse New Freedom when its actual loss “arises out of” (1) the issuing agent's failure to follow New Freedom's written closing instructions relating to the

collection and payment of funds due to New Freedom, or (2) the issuing agent's “[f]raud or dishonesty ... in handling [New Freedom's] funds or documents in connection with such closings. . . .”

[A] residential closing occurred on July 14, 2000 wherein New Freedom made a \$216,000 loan to Shelton Goode secured by real property located in Atlanta, Georgia. In connection with the closing, Lawyers Title issued a lender's title insurance policy to New Freedom. The issuing agent for the title insurance policy and closing attorney for the transaction was Michael Brochstein and his law firm, Brochstein, Bantley & Babcock. The parties agree that the [closing protection letter] was in effect and binding at the time of the closing, and that Brochstein's client was New Freedom under Georgia real estate law.

The HUD-1 settlement statement transmitted to New Freedom . . . reflected that the residential property had been appraised at \$240,000 and that the buyer Goode was contributing \$25,640.06 of his personal funds towards the purchase. However . . . the sale of the property was a sham transaction involving a straw purchaser and an inflated property appraisal. In the months after the sale, no payments were made on the loan, resulting in the foreclosure and sale of the property for significantly less than the appraised value. In total, New Freedom incurred losses in the amount of \$54,922.30. After the parties were unable to resolve their dispute over coverage, New Freedom filed suit against Lawyers Title seeking reimbursement for its losses under the [closing protection letter].

The central issue at trial was whether Brochstein participated in the mortgage fraud scam against New Freedom, such that his conduct as an issuing agent for Lawyers Title entitled New Freedom to

¹⁸² *Id.* at *1.

¹⁸³ *Lawyers Title Insurance Corp. v. New Freedom Mortgage Corp.*, 645 S.E.2d 536 (Ga. Ct. App. 2007).

¹⁸⁴ *See id.* at 538-39.

¹⁸⁵ *Id.* at 538.

indemnification under the [closing protection letter]. New Freedom presented evidence that Brochstein disregarded the written closing instructions provided to him by New Freedom and acted fraudulently and dishonestly in handling New Freedom's funds and documents in connection with the closing. Accordingly, New Freedom argued that its losses were reimbursable under the [closing protection letter] because the losses arose both out of Brochstein's failure to follow New Freedom's closing instructions and his fraud and dishonesty.

In rebuttal, Lawyers Title relied on the testimony of Brochstein, who denied that he knew about or participated in the mortgage fraud scam or that he had failed to follow the closing instructions as written. The trial court also permitted Lawyers Title to argue and present evidence that New Freedom's *sole* negligence caused New Freedom's loss, but ruled that Lawyers Title could not argue or introduce evidence that the loss was caused *in part* by the contributory negligence of New Freedom or other third parties. This was based on the trial court's ruling that, pursuant to the terms of the [closing protection letter] and Georgia indemnity law, New Freedom only had to show a slight causal connection between New Freedom's loss and Brochstein's alleged fraud, dishonesty, or failure to follow the written closing instructions in order to obtain full reimbursement. . . . The jury subsequently returned a verdict in favor of New Freedom.¹⁸⁶

On appeal, Lawyers Title argued that certain jury instructions were improper, including the instruction on misrepresentation.¹⁸⁷ With respect to misrepresentation, the trial court charged:

Misrepresentation of a material fact, if acted on by the opposite party, constitutes legal fraud, whether misrepresentation was intentional or not.

If there is a willful misrepresentation of a material fact which was made to induce another to act and causes that person to act and the person is injured, then the person who was injured has the right of action. Mere concealment of a fact, unless it is done to deceive and mislead, will not support an action.

In all cases of deceit, knowledge of the falsehood constitutes an essential element. However, fraudulent or reckless misrepresentation of facts as true which the party may not know to be false, if intended to deceive, is equivalent to knowledge of a falsehood. (emphasis in original).¹⁸⁸

The trial court noted that the emphasized portion of the charge accurately reflects the concept of constructive fraud, a concept recognized under Georgia law.¹⁸⁹ However, given the language in the closing protection letter, the trial court found that “the concept of constructive fraud was not applicable in this case.”¹⁹⁰ While the closing protection letter “indemnified New Freedom against the issuing agent's ‘[f]raud or dishonesty’,” the trial court interpreted “fraud” to mean actual rather than constructive fraud, given the fact that the contract did not simply allow for rescission, but instead required Lawyers Title to pay damages to New Freedom in an amount representing New Freedom's actual losses resulting from the issuing agent's conduct.¹⁹¹ As such, the Georgia Court of Appeals found that the emphasized portion of the trial court's charge, which stated that a finding of intent was not necessary to

¹⁸⁶ *Id.* at 538-39.

¹⁸⁷ *Id.* at 539.

¹⁸⁸ *Lawyers Title* at 539-40.

¹⁸⁹ *Id.* at 540.

¹⁹⁰ *Id.*

¹⁹¹ *Id.*

establish legal fraud, was not tailored to the law and evidence applicable here, constituting reversible error.¹⁹²

Appraisers

*Hoffman v. Stamper*¹⁹³

In August 1998, Arthur Hoffman and several others were sued in the Circuit Court for Baltimore City for fraud, conspiracy to defraud, and violations of the Consumer Protection Act.¹⁹⁴ Hoffman and his co-defendants were accused of acquiring inexpensive, “dilapidated residential properties,” misleading prospective buyers into believing they were purchasing “rehabbed” houses, or, at least, houses that would be completely renovated by the time of settlement, misrepresenting the appraised value of the properties, and then selling the properties to those buyers at greatly inflated prices.¹⁹⁵ After closing, the buyers were left with properties that were “either uninhabitable or in seriously decayed condition, and [were] worth far less than the mortgage loan[s] taken to buy [them].”¹⁹⁶

Hoffman’s role in the scheme was critical to its success. The scheme involved obtaining Federal Housing Administration-backed (“FHA”) loans for the buyers.¹⁹⁷ To obtain an FHA loan to purchase property, an FHA-approved appraiser (Hoffman) had to inspect the property, and “the appraised value had to reflect at least the purchase price of the property on which the loan [was] extended.”¹⁹⁸ Hoffman valued each property, except for one, for the purchase price.¹⁹⁹ To arrive at the inflated

values, Hoffman used false information furnished by his co-defendants “conceal[ing] that the information in fact was tainted and unreliable.”²⁰⁰ The values Hoffman arrived at for five of the eight properties at issue “greatly exceeded even the highest possible value ranges.”²⁰¹

*Deutsche Bank National Trust Co. v. Budkofsky*²⁰²

The Defendants, a real estate appraiser and his appraisal company, moved to dismiss “the first count of the plaintiff’s complaint,” which asserted a claim under Connecticut’s Unfair Trade Practices Act (“CUTPA”) against the defendant.²⁰³ The defendants sought to dismiss that claim on the basis that there is no viable CUTPA claim against a real estate appraiser who commits malpractice.²⁰⁴

In this case, the plaintiff alleged that:

the defendants issued a written appraisal report for [a property in Hartford, Connecticut,] valuing the property and improvements at \$120,000. Less than two weeks later, the property owner borrowed \$108,000 and, as collateral, conveyed a mortgage to Ameriquest Mortgage Company for the property. Ameriquest then assigned its rights to the Plaintiff, the present mortgage holder. The note and mortgage [went into] default and the plaintiff has a pending foreclosure on the property.

The plaintiff alleges that the appraisers “intentionally and willfully inflated the value of the premises” by “having the appraised value meet the amount of the sales contract, which was not an arm’s

¹⁹² See *id.* at 540-41.

¹⁹³ *Hoffman v. Stamper*, 843 A.2d 153 (Md. Ct. Spec. App. 2004), *aff’d in part, rev’d in part* 867 A.2d 276 (Md. 2005).

¹⁹⁴ See *id.* at 163.

¹⁹⁵ *Id.* at 165-66.

¹⁹⁶ *Id.* at 166.

¹⁹⁷ See *id.* at 172.

¹⁹⁸ *Hoffman*, 843 A.2d at 172.

¹⁹⁹ *Id.* at 172.

²⁰⁰ *Id.* at 185.

²⁰¹ *Id.*

²⁰² *Deutsche Bank National Trust Co. v. Budkofsky*, No. CV040834536, 2006 WL 1229756 (Conn. Super. Ct. April 12, 2006).

²⁰³ *Id.* at *1

²⁰⁴ *Id.*

length contract ... [and] by issuing an appraisal report which intentionally inflated the value of the premises to induce a creditor to extend credit.” In addition, the plaintiffs allege that the defendants failed to: “(1) detect and uncover a [property] ‘flip’ and . . . (3) identify a reasonable and probable price of the property in a competitive and open market. . . .”²⁰⁵

The court noted that “[t]here is a split of authority among the Superior Courts as to whether the CUTPA exclusion for medical and legal malpractice extends to professions such as an appraiser.”²⁰⁶ However, as the court noted in *Advanced Financial Services, Inc. v. Associated Appraisal Services, Inc.*,²⁰⁷ relying on *Haynes v. Yale-New Haven Hospital*,²⁰⁸ the court found “that a real estate appraiser violated CUTPA after the appraiser had submitted a Certificate of Satisfactory Completion when the work was not completed, failed to disclose that the property was vandalized and forged the actual appraiser’s name. The court recognized that while professional malpractice cases are normally outside the scope of CUTPA,” a professional can be subject to CUTPA claims “where deceptive acts such as forgery, deliberate falsification and nondisclosure are alleged.”²⁰⁹

Relying on the holding in *Advanced Financial Services* and *Haynes*, the court denied the appraiser’s motion to dismiss because the plaintiff had “alleged that the appraiser issued an intentionally false appraisal to induce a creditor to extend credit.”²¹⁰ The court found that this claim “assert[ed] a deceptive practice” and was

“sufficient to support a CUTPA claim.”²¹¹

Real Estate Brokers

In *Helmar v. Harsche*²¹², the purchaser of a “triplex” rental unit sued the real estate brokers, seeking compensation for damages incurred when the property was found not to be registered, as required by state law, and was not in conformity to applicable building codes.²¹³ Prior to trial, the brokers “sought leave to name plaintiff’s attorney in the real estate transaction as a third-party defendant. Defendants argued that the attorney was negligent and sought indemnification and contribution under the Joint Tortfeasors Contribution Law and an assessment of negligence under the Comparative Negligence Act.”²¹⁴ The court denied the defendants’ motion, and the matter went to trial.²¹⁵ At trial, the jury found that the defendants “had committed consumer fraud” and were liable to plaintiff for \$5,450, which was trebled to \$16,350.²¹⁶

On appeal, defendants raised several issues, including the trial court’s failure to allow the defendants to file a third-party complaint against the plaintiff’s real estate attorney.²¹⁷ The New Jersey Superior Court, Appellate Division agreed, noting that the brokers should have been allowed to join attorney for purchaser and assert a legal malpractice claim against him, even though attorneys are ordinarily not liable to nonclients because the attorney had “a fiduciary duty to [the brokers] to facilitate the transaction to successful conclusion,” which he arguably violated by failing to determine if the property complied with requisite law.²¹⁸ In arriving at this determination, the New Jersey Superior

²⁰⁵ *Id.*

²⁰⁶ *Id.*

²⁰⁷ *Advanced Financial Services, Inc. v. Associated Appraisal Services, Inc.*, No. CV 98 0580372, 2001 WL 951324 (Conn. Super. Ct. July 23, 2001).

²⁰⁸ *Haynes v. Yale-New Haven Hospital*, 699 A.2d 964 (Conn. 1997).

²⁰⁹ *Deutsche Bank*, 2006 WL 1229756, at *1 (citing *Advanced Financial Services*, 2001 WL 951324, at *5).

²¹⁰ *Id.*

²¹¹ *Id.* at *1-2.

²¹² *Helmar v. Harsche*, 686 A.2d 766 (N.J. App. Div. 1996).

²¹³ *Id.* at 768-70.

²¹⁴ *Id.* at 767 (citations omitted).

²¹⁵ *Id.*

²¹⁶ *Id.*

²¹⁷ *See Helmar*, 686 A.2d at 768.

²¹⁸ *Id.* at 771-73.

Court, Appellate Division relied on expert testimony rendered by the plaintiff's expert and two of the brokers' experts who opined that it was the attorney's duty to assure compliance with the statute.²¹⁹ The New Jersey Superior Court, Appellate Division noted that had the attorney "performed his duty after the contract was executed" to assure proper compliance with the multiple dwelling law, "the failure to comply [with that] law would have become evident," thus resulting in the contract of sale having to be "amended to protect plaintiff or might have [even] been rescinded."²²⁰

Title Insurance Company

*Security Union Title Insurance Co. v. Citibank*²²¹

The Court held that a title insurer that allowed a lawyer to act as an agent in making title commitments and issuing policies conferred no apparent authority and therefore, the title insurer was not vicariously liable to the lender for alleged fraud as the attorney and closing agent for the borrower and as a partner for another borrower.²²² The lender made no representations of capacity as agent for borrower and as partner for another borrower.²²³ The lender made no representations of capacity as agent outside the actual authority and the insurer accurately listed conveyances, did not cause alleged fraud and "owed [no] duty to discover or disclose underlying facts about the value of the land or the familial relationships" of the borrowers.²²⁴

*TrustCorp Mortgage Co. v. Zajac*²²⁵

²¹⁹ *Id.* at 773.

²²⁰ *Id.*

²²¹ *Security Union Title Insurance Co. v. Citibank*, 715 So. 2d 973 (Fla. Dist. Ct. App. 1998).

²²² *See id.* at 975-76.

²²³ *Id.* at 975.

²²⁴ *Id.* at 976.

²²⁵ *TrustCorp Mortgage Co. v. Zajac*, No. C-060119, 2006 WL 3690299 (Ohio Ct. App. Dec. 15, 2006).

In this case, the Court held that a mortgage lender may not "recover economic losses from an appraiser, in the absence of privity of contract, under the theory of negligent misrepresentation."²²⁶ However, this decision is indicative of the split of authority in Ohio on this decision where other courts have held that an appraiser can be liable for economic damages when the "appraiser[] provides an inaccurate appraisal to a lender or a purchaser, despite the absence of privity of contract between the parties."²²⁷

Predatory Lending Practices and Minorities

In *Barkley v. Olympia Mortgage Co.*,²²⁸ eight plaintiffs, who were "first time homebuyers," filed "suit against real estate companies, lenders, appraisers, and lawyers" alleging discrimination in violation of various federal anti-discrimination statutes, including the Fair

²²⁶ *Id.* at *1.

²²⁷ *Id.* at *4; *see e.g.*, *Wash. Mut. Bank v. Smith*, No. 2001-L-238, 2002 WL 31812944, at *4 (Ohio Ct. App. Dec. 13, 2002) ("an appraiser preparing a report for a lending institution should foresee that the purchaser of the property listed on the appraisal form could be within the limited class of persons who would rely on the appraisal"); *Perpetual Fed. Sav. & Loan Ass'n. v. Porter & Peck, Inc.*, 609 N.E.2d 1324, 1326-28 (Ohio Ct. App. 1992) (an appraiser of real property could be liable in tort for economic damages to a lending institution where the lender had not contracted for the appraisal report but had received it from a mortgage broker who had. The appraiser had negligently misrepresented the appraised property's compliance with the applicable zoning regulations. The lender allegedly relied on the appraiser's representation in deciding to lend money to a purchaser of the property.); *but see Hancock v. Sigg*, No. WM-95-010, 1995 WL 516492, at *2 (Ohio Ct. App. Sept. 1, 1995) (sellers of home were "not among the limited class of persons whose reliance on an appraiser's valuation of a property could be specifically foreseen.").

²²⁸ *Barkley v. Olympia Mortgage Co.*, No. 04-CV-875 (RJD)(KAM), 2007 WL 2437810 (E.D.N.Y. Aug. 22, 2007).

Housing Act.²²⁹ Plaintiffs also asserted state “claims of fraud, conspiracy to commit fraud, legal malpractice, negligence,” and violations of New York’s consumer protection statute.²³⁰ The nature of plaintiffs’ claims were that the defendants targeted the plaintiffs because they were minorities in a conspiracy to sell them over-valued homes with defects financed by predatory loans.²³¹

Plaintiff Sandra Barkley also alleged that her lender, Olympia Mortgage Corporation violated the Truth in Lending Act (“TILA”).²³² All of the defendants filed motions to dismiss under Federal Rules of Civil Procedure 12(b)(1) and 12(b)(6).²³³

The plaintiffs asserted that the “defendants were part of a fraudulent property-flipping scheme” where defendant “United Homes and its affiliated companies bought damaged properties at foreclosure auctions or estate sales.”²³⁴ Plaintiffs alleged that United Homes “performed some cosmetic repairs” and soon thereafter, sold the homes, “often at double the purchase price.”²³⁵ Plaintiffs claimed that the defendants targeted minorities with “limited financial means and savvy” with no prior home buying experience.²³⁶ Plaintiffs further alleged that they were only shown homes in predominately minority neighborhoods, intentionally paired up with minority brokers, and that the defendants “engaged in ‘reverse redlining,’ the practice of intentionally extending credit to members of minority communities on unfair [credit] terms.”²³⁷ As a result of the defendants’ conduct and fraud, plaintiffs were “burdened by mortgages they cannot afford and are at risk of losing their homes.”²³⁸

²²⁹ *Id.* at *1.

²³⁰ *Id.*

²³¹ *Id.*

²³² *Id.*

²³³ *Barkley*, 2007 WL 2437810, at *1.

²³⁴ *Id.*

²³⁵ *Id.*

²³⁶ *Id.*

²³⁷ *Id.* at *1-2.

²³⁸ *Barkley*, 2007 WL 2437810, at *2.

In addressing the various motions to dismiss, the court granted Olympia’s motion to dismiss Ms. Barkley’s TILA claim based on the one year statute of limitations applicable to such claims.²³⁹

The court noted that the one year statute of limitations for TILA claims typically begins to run on the date the “plaintiff enter[ed] into [the] loan agreement.”²⁴⁰ Since Ms. Barkley’s complaint was filed almost fourteen (14) months after the mortgage was signed, Ms. Barkley’s TILA claim was time-barred.²⁴¹ The court did not dismiss the fraud and Fair Housing Act claims asserted by one of the plaintiffs against an appraiser, Joseph Gaeta, as being time-barred.²⁴² The court denied the remaining motions to dismiss on the basis that plaintiffs had plead viable claims against the defendants.²⁴³

In denying the remaining motions to dismiss, the court noted that 42 U.S.C. sections 1981 and 1982 “ban discrimination in various financial transactions, including making and enforcing contracts and purchasing real and personal property.”²⁴⁴ With respect to the allegations of “reverse redlining”, the court noted that “[a]lthough the Second Circuit ha[d] not yet held that reverse-redlining claims were cognizable under the Fair Housing Act, courts in other circuits had. . . .”²⁴⁵ The court, in accepting reverse-redlining claims, noted that under such a claim, a plaintiff must show:

- 1) that [plaintiff] is a member of a protected class;
- 2) that [plaintiff] applied for and was qualified for loans;
- 3) that the loans were given on grossly unfavorable terms; and
- 4) that the lender continues to provide loans to other applicants with

²³⁹ *Id.* at *17.

²⁴⁰ *Id.*

²⁴¹ *Id.*

²⁴² *Id.* at *15-23.

²⁴³ *Barkley*, 2007 WL 2437810, at *10-23.

²⁴⁴ *Id.* at *10.

²⁴⁵ *Id.* at *13.

similar qualifications, but on significantly more favorable terms . . . [or]

that the lender intentionally targeted [plaintiff] for unfair loans on the basis of sex and marital status. . . .²⁴⁶

As of May 2008, this case is still ongoing. Parties are participating in settlement talks at this time.

VIII. HELPFUL TIPS TO AVOID BECOMING AN UNSUSPECTING MEMBER OF AN ILLEGAL FLIPPING SCHEME

In conclusion, there are several preventative measures that attorneys and law firms can use to help avoid becoming involved in an illegal flip scheme or involved as a party in litigation relating to an illegal flip scheme:

- 1) Explain all actions to your client;
- 2) Provide the client with accurate and truthful information;
- 3) Put everything in writing;
- 4) Carefully monitoring all business practices within the firm;
- 5) Follow up on obtaining “releases on paid off mortgages and making sure outstanding escrow issues are cleared;”
- 6) Obtain “lien affidavits for judgments that appear on title report but are not against the borrower;”
- 7) Checks and balances in the law firm to make sure the necessary recordation and other closing documents are completed in a timely manner and recorded properly’
- 8) Meticulous compliance with escrow closing instructions;
- 9) Put all parties, including new lenders, on written notice of a flip,

even if it is a legal property flip transaction;

- 10) Do not close deals where the down payment “is in the form of an undisclosed second lien” unless the new lender is put on notice of that fact;
- 11) Check with the state’s corporation bureau web site “if you suspect an artificial entity or other foul play in a closing;”
- 12) If you have questions or concerns, “always check with the title insurance underwriter;” and
- 13) It never hurts to “[h]ave a colleague review the file after closing to make sure” closing instructions were followed and that the closer and conveyances have done their job properly.²⁴⁷

²⁴⁶ *Id.*

²⁴⁷ Tierney, *supra* note 60, at 91-92.

A. U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT			SETTLEMENT STATEMENT		
B. TYPE OF LOAN		6. File Number:		7. Loan Number:	
1. X FHA	2. FmHA				
3. Conv. Unins.	4. VA	8. Mortgage Insurance Case Number			
C. NOTE: This form is furnished to give you a statement of actual settlement costs. Amounts paid to and by the settlement agent are shown. Items marked "(p.o.c.)" were paid outside the closing; they are shown here for informational purposes and are not included in the totals. NOTE: TIN = Taxpayer's Identification Number					
D. NAME AND ADDRESS OF BORROWER:		E. NAME, ADDRESS AND TIN OF SELLER:		F. NAME AND ADDRESS OF LENDER:	
G. PROPERTY LOCATION:		H. SETTLEMENT AGENT NAME, ADDRESS AND TIN			
		PLACE OF SETTLEMENT		I. SETTLEMENT DATE	

J. SUMMARY OF BORROWER'S TRANSACTION		K. SUMMARY OF SELLER'S TRANSACTION	
100. GROSS AMOUNT DUE FROM BORROWER:		400. GROSS AMOUNT DUE TO SELLER:	
101. Contract sales price		401. Contract sales price	
102. Personal property		402. Personal property	
103. Settlement charges to borrower (Line 1400)		403.	
104.		404.	
105.		405.	
Adjustments for items paid by seller in advance		Adjustments for items paid by seller in advance	
106. City/town taxes		406. City/town taxes	
107. County taxes		407. County taxes	
108. Assessments		408. Assessments	
109.		409.	
110.		410.	
111.		411.	
112.		412.	
120. GROSS AMOUNT DUE FROM BORROWER		420. GROSS AMOUNT DUE TO SELLER	

200. AMOUNTS PAID BY OR IN BEHALF OF BORROWER:		500. REDUCTIONS IN AMOUNT DUE TO SELLER:	
201. Deposit or earnest money		501. Excess deposit	
202. Principal amount of new loan(s)		502. Settlement charges to seller (Line 1400)	
203. Existing loan(s) taken subject to		503. Existing loan(s) taken subject to	
204.		504. Payoff of first mortgage loan	
205.		505. Payoff of second mortgage loan	
206.		506.	
207.		507.	
208.		508.	
209.		509.	
Adjustments for items unpaid by seller		Adjustments for items unpaid by seller	
210. City/town taxes		510. City/town taxes	
211. County taxes		511. County taxes	
212. Assessments		512. Assessments	
213.		513.	
214.		514.	
215.		515.	
216.		516.	
217.		517.	
218.		518.	
219.		519.	
220. TOTAL PAID BY/FOR BORROWER		520. TOTAL REDUCTION AMOUNT DUE SELLER	

300. CASH AT SETTLEMENT FROM/TO BORROWER		600. CASH AT SETTLEMENT FROM/TO SELLER	
301. Gross amount due from borrower (Line 120)		601. Gross amount due to seller (Line 420)	
302. Less amount paid by/for borrower (Line 220)		602. Less reduction in amount due seller (Line 520)	
303. CASH FROM BORROWER		603. CASH TO SELLER	

SELLER'S STATEMENT

The information contained in Blocks E, G, H, and I and on line 401 (or, if line 401 is asterisked, line 403 and 404) is important tax information and is being furnished to the Internal Revenue Service (see Seller Certification). If you are required to file a return, a negligence penalty or other sanction will be imposed on you if this item is required to be reported and the IRS determines that it has not been reported. You are required to provide the Settlement Agent with your correct taxpayer identification number. If you do not provide the Settlement Agent with your correct taxpayer identification number, you may be subject to civil or criminal penalties imposed by law. Under penalties of perjury, I certify that the number shown on this statement is my correct taxpayer identification number.

(Seller's Signature)

(Seller's Signature)

L. SETTLEMENT CHARGES

	PAID FROM BORROWER'S FUNDS AT SETTLEMENT	PAID FROM SELLER'S FUNDS AT SETTLEMENT
700. TOTAL SALES/BROKER'S COMMISSION based on price \$ @		
Division of Commission (line 700) as follows:		
701. \$		
702. \$		
703. Commission paid at Settlement		
704.		
800. ITEMS PAYABLE IN CONNECTION WITH LOAN		
801. Loan Origination Fee \$		
802. Loan Discount \$		
803. Appraisal Fee to		
804. Credit report to		
805. Lender's Inspection Fee		
806.		
807.		
808.		
809.		
810.		
811.		
812.		
813.		
900. ITEMS REQUIRED BY LENDER TO BE PAID IN ADVANCE		
901. Interest from		
902. Mortgage Insurance Premium for		
903. Hazard insurance Premium for		
904.		
905.		
1000. RESERVES DEPOSITED WITH LENDER		
1001. Hazard insurance		
1002. Mortgage insurance		
1003. City Property Taxes		
1004. County Property Taxes		
1005. Annual assessments		
1006.		
1007.		
1008. Aggregate Accounting Adjustment	0.00	
1100. TITLE CHARGES		
1101. Settlement or closing fee to		
1102. Abstract or title search to		
1103. Title Examination to		
1104. Title insurance binder to		
1105. Document preparation to		
1106. Notary fees to		
1107. Attorney's fees to (includes line numbers:		
1108. Title Insurance to (includes line numbers:		
1109. Lender's coverage \$		
1110. Owner's coverage \$		
1111.		
1112.		
1113.		
1200. GOVERNMENT RECORDING AND TRANSFER CHARGES		
1201. Recording fees: Deed \$ Mortgage \$ Release \$		
1202. City/cnty tax/stamps: Deed \$ Mortgage \$		
1203. State tax/stamps: Deed \$ Mortgage \$		
1204.		
1205. Realty Transfer Fee Tax		
1300. ADDITIONAL SETTLEMENT CHARGES		
1301. Survey to		
1302. Pest inspection to		
1303.		
1304.		
1305.		
1306.		
1400. TOTAL SETTLEMENT CHARGES (enter on lines 103, Section J and 502, Section K)		

CERTIFICATION: I have carefully reviewed the HUD-1 Settlement Statement and to the best of my knowledge and belief, it is a true and accurate statement of all receipts and disbursements made on my account or by me in this transaction. I further certify that I received a copy of the HUD-1 Settlement Statement.

Seller

Borrower

Seller

Borrower

The HUD-1 Settlement Statement which I have prepared is a true and accurate account of the funds disbursed or to be disbursed by the undersigned as part of the settlement of this transaction.

Settlement Agent Robert J. Machi

Date

WARNING: It is a crime to knowingly make false statements to the United States on this or any other similar form. Penalties upon conviction can include a fine and imprisonment. For details see: Title 18 U.S. Code Section 1001 and Section 1010.