IS FORCE-PLACED FIRE THE NEW GOLDEN GOOSE?

As CPI lost favor with most of national lenders over the past decade, litigation opportunities declined dramatically. As a result, some attorneys seem to be setting their sights on forced placed fire (MPI). Historically, MPI has not been subject to litigation and most awards and settlements have been small in comparison to CPI; probably because MPI has not been subject to the exploitive practices alleged of the CPI business.

Most of these cases allege: breach of contract, unjust enrichment, breach of duty of good faith and fair dealing, breach of fiduciary duty, negligence, fraud, breach of a duty to a third party beneficiary, breach of an implied contract, violation of RICO and the federal Fair Debt Collection Practices Act and other unfair business practices,

While defense of these litigations have by and large been successful, all producers and clients should become familiar with the common themes of the recent rash of MPI litigations.

Gipson v. Fleet Mortgage Group, Inc. (U.S. S. D. MS, 11/7/2002): Gipson alleged wrongful conduct by both Fleet and American Security, challenging the adequacy, cost and "necessity" of the MPI coverage, and failure to disclose the existence of financial arrangements between ASIC and Fleet. Gipson challenged Fleet's right to place MPI in a manner that caused its borrowers to pay unnecessary fees. In summary judgment, the court concluded that ASIC was not a party to contract authorizing placement of insurance and owes no duty of good faith and fair dealing to borrower. ASIC did not have a duty to disclose its financial relationship with Fleet.

Custer v. Homeside Lending (Supreme Court AL, 3/14/2003): The mortgage did not specifically require Custer to maintain flood insurance but did require Custer to maintain insurance as may be required from time to time by the lender against "fire and other hazards, casualties and contingencies in such amounts and for such periods as may be required by the mortgagee". The loan balance was $2,000 yet Homeside force-placed $79,000 in NFIP flood coverage (the last known hazard insurance amount). Custer denied knowledge of the forced placement and alleged the usual breaches. Custer asserted that they were a third party beneficiary to agreements between Homeside and WNC with respect to their equity in the property because Homeside purchased "excessive flood insurance". The Supreme Court held that contractually, Homeside was given the right to force place a higher amount, under the provisions of the mortgage authorizing it to force place insurance against loss "in such amounts" as it might choose to require. Homeside did not breach the terms of the mortgage by force placing an amount that exceeded the loan balance. While the mortgage terms allowed insurance for more than the loan balance, Section 4012a(b) of the NFIA was also used in support of this action. The NFIA would not be an available defense for MPI coverage in excess of the loan balance.

Hall v. Midland Group (U.S. E. D. PA, 11/17/2000): The court approved a $1.75 Million settlement of class action claims against Midland Mortgage. The complaint alleges MPI premium assessed by agencies owned by Midland affiliates, were excessive and unauthorized. The class encompassed 43,000 members over 20 years. In addition to the issue of commissions accepted by affiliates, the complaint also targeted inadequate disclosures of the nature, cost and scope of force-placed coverage. The $1.75 million recovery fund represents only 16.3% of the commissions realized on the insurance premiums. This is to be shared with all class members, including flat cancellations. The class overlapped with an action filed in the Southern District of Georgia captions Kirkland v. Midland Mortgage Company (whose demand is over $5 Million).

Hardison v. Balboa (U.S. Court of Appeals, W. D. OK, 2/16/2001): United Companies cancelled their MPI policy several months prior to a tornado loss to the Hardison home. Hardison contended that she never received notice and alleged that: (a.) Balboa's failure to provide notice constituted a bad faith breach of insurance contract and violated the Oklahoma Consumer Credit Code; (b.) Balboa was liable for failing to procure insurance; and (c.) Balboa was vicariously liable

under an agency or joint venture theory for the United (Insured) alleged wrongful cancellation of the policy. The court rejected the argument that the Insured cannot cancel the policy without first obtaining the consent of "additional insured". (Note: FIS did not find where the borrower had established that they were an additional insured but found reference to a standard fire policy being part of the Balboa policy). Balboa had no legal duty to notify Hardison of the cancellation. The court found no evidence of an agency or joint venture relationship between Balboa and United. The court also determined that Balboa had no duty to procure insurance in the absence of a borrower requesting coverage.

Pearlman v. Bank of America (San Diego Superior Court, CA, 3/30/1998): At issue was: (a.) force placing coverage beyond those provided by a basic fire and extended coverage policy without the permission of the borrower, (b.) force placing and charging borrowers for insurance greater than the replacement cost of the improvements on the land, (c.) affiliated entities receiving commission and other compensation, and (d.) receiving tracking services from American Security at a cost below the market cost at arm's length. This was settled for $600,000.

Weatherby v. The Associates Financial Services (U.S. E. D. LA, 4/28/99): The court dismisses claims alleging RICO violation for fraudulently force-placing and charged overpriced insurance to borrowers loans. Plaintiff failed to adequately plead the required "investment injury" and "acquisition injury" under RICO.

Conley v. Norwest Mortgage (Superior Court of CA, San Diego County, 11/22/99): This suit alleges that Norwest unfairly, deceptively and unlawfully charged borrowers for MPI in violation of Business & Professional Code 17200. In part, plaintiff alleges that MPI premium should not include components for commissions and tracking expense. Plaintiff filed an administrative rate review petition with the California DOI against American Security. The DOI was asked to decide: (a.) should an insurance rate approved by the DOI include charges that relate to the general insurance services rendered by the lender, and (b.) whether rates approved by the DOI may include charges that are improperly passed on by the lenders to borrowers. The DOI has responded that American Security's decision to include tracking services and commission as components of the rate structure do not make the rates excessive. The DOI would not express an opinion as to whether lenders can or should pass premium charges on to their borrowers. This litigation is pending.

Weinberger v. Mellon Mortgage and Balboa Insurance (U.S. E. D. PA, 9/98): Mellon was accused of breach of contract, breach of duty of fair dealing, unjust enrichment, and violations of RICO and the Fair Debt Collection Practices Act. Balboa was accused of unjust enrichment and RICO violations. Plaintiff claimed that Mellon and Balboa together were an association-in-fact constituting a RICO enterprise conducting enterprise affairs through a pattern of racketeering. This was based upon premiums being excessive and Mellon receiving rebates and/or commissions from Balboa. This case was dismissed.

Munford v. Lee Servicing Company (P.2d 23, Utah 4/20/2000): After insurance lapsed on a second mortgage, Lee ordered MPI. Prior to receiving the bill for MPI, the borrower replaced their lapsed policy retroactive to the date of the lapse. A fire ensued that was not fully covered by borrower insurance. The borrower subsequently pays the MPI premium in order to sue Lee for proceeds from the MPI policy. Lee claimed the MPI policy was void at inception because the borrower obtained insurance retroactive to the lapse date. The trial court dismissed the case. The Utah Appeals Court reversed the dismissal, as a question of fact exists as to whether the MPI policy operated as supplemental coverage. Lee argued that the Other Insurance clause stated that if coverage is "also provided by other insurance, the coverage under this policy will terminate as of the effective date of the other insurance and the applicable premium refunded". The court focused on: (a.) the coverage being excess insurance by nature for second mortgages, (b.) the existence of supplemental coverages and it not being replacement coverage, (c.) premium being billed after Lee received notice that the borrower obtained other insurance, and

(d.) differences in copies of the policies produced by Lee and the borrower. This all created an ambiguity between policy intent and the Other Insurance clause.

Gibson v. World Savings & Loan Assn. (Fourth Appellate, CA, 11/27/2002): Gibson alleged that premiums were excessive in that they included the cost of Balboa's tracking services and that World had falsely represented that the premium charged to the borrower was equal to the real cost of that insurance. Although World was entitled to simply reinstate the borrower's policy, World forced placed insurance that was more expensive than the borrower's policy. World benefited financially from purchasing the more expensive policies to the extent that World applied the excess funds to pay for tracking services that World would otherwise have paid itself as part of its administrative overhead. By charging borrower's for the full price of the MPI, World violated the terms of the borrower's deed of trust which authorized World to advance funds on behalf of the borrower only to the extent necessary to protect World's interest.

In 1999, the trial court dismissed all counts except for unfair business practices on the basis of federal preemption for a federal lending institution. The court stated that, were it not preempted, it would have found that, by charging its defaulting borrowers an insurance premium that includes unrelated tracking costs that benefit World only, World had violated the terms of the deed of trust and engaged in unfair business practices under Business and Professional Code section 17200.

The Appellate Court reversed the trail courts preemption decision; noting that neither the federal "filed rate" doctrine nor DOI jurisdiction over insurance rates bars suit as Balboa is not a defendant and their rates are not being challenged. Rather, borrowers contend that World improperly insisted that the borrowers reimburse World for costs which the borrowers were not contractually obligated to pay. This litigation will be proceeding. This is an interesting one in light of the DOI opinion obtained in the Conley v. Norwest Mortgage.

Severson v. Chase Manhattan Mortgage (NJ): Dismissed

Ramos v. Countrywide (Fourth Appellate District, CA): The underlying litigation filed in 1995 was settled for $3.2 Million. A separate action awarded $2.3 Million in attorney fees. The Appeals Court has remanded the decision on attorney fees back to the trial court.

Four states now have CPl Acts applicable to real estate (IL, MO. TX and WV) and 9 states prohibit forced placement of homeowners coverage without the borrower's written approval (CT, HI, IL, KS, NM, NY, OH, TX and WA). In several of these cases, litigation may have been averted by improved disclosure in the mortgage and borrower notices. This is one area that we all need to concentrate on.

This is a summary of issues identified in a cursory review made by FIS. This summary was not prepared by the Legal Department of Great American and should not be considered a legal opinion or analysis. Contact FIS or check our website, www.GreatAmericanFIS.com for more information.