Title Insurance Complexities in Tax Foreclosure Purchases

BY ADAM LEITMAN BAILEY AND DOV TREIMAN

For the past four years, nearly every title company providing title insurance in the United States of America has been scrambling to interpret federal and state court decisions setting the rules for determining when a tax foreclosure sale will be safe from judicial knockouts. When the U.S. Supreme Court decided *Jones v. Flowers* (2006), it exacerbated a nagging problem for the title insurance industry—the necessity to do constitutional analysis when examining chains of title. With more tax foreclosures, more properties have these ambiguities in their chains of title, leaving title underwriters with the decision of whether to except these conveyances from coverage under the insurance policies and leave purchasers with the decision of whether to forego insured protection. ■ Many states amended their statutes in response to *Jones* to account for the new level of taxpayer protection constitutionally mandated. While these new statutes typically address the purely mechanical requirements *Jones* imposes, very few of them create schemes elaborate enough to satisfy a court every time that the amorphous goals of *Jones*—that of making a genuine effort to find the delinquent taxpayer—will, in every case, be satisfied. In spite of these concerns, there are measures to take to make these transactions as reasonably safe as any other.

How a Supreme Court decision affects the way chains of title are examined when it comes to purchases of tax-foreclosed properties.

The *Jones* dilemma

Jones enunciated two standards applicable to governments when foreclosing on tax liens. The first is that "the government [is required] to consider unique information about an intended recipient regardless of whether a statutory scheme is reasonably calculated to provide notice in the ordinary case." The second standard is that the government must behave as "a person who actually desired to inform a real property owner of an impending tax sale."

The result of these two standards is that "when the government learns its attempt at notice has failed, due process requires the government to do something more before real property may be sold in a tax sale."

These standards are hazardous for the title industry, because what *Jones* calls "unique information" rarely appears in the public record and cannot be gleaned by any of the normal research methods.

For example, in *89 Pine Hollow Road Realty Corp. v. American Tax Fund, Foothill,* in a 2007 action by the delinquent taxpayer against a remote purchaser down the chain from the foreclosure, New York's Second Department (the intermediate appellate court covering parts of New York City and all of its suburbs) found that *Jones* created an ambiguity that eluded summary judgment and required a trial on the question of who knew what about how to reach the delinquent taxpayer. Thus, the title was found to be questionable.

Conflicting philosophies

Contrary to commonly held belief, *Jones* nationalized an already common standard. *Jones* looked at the various tax foreclosure statutes across the nation and realized that they ranged from laws that barely made any effort to inform debtors of an impending tax foreclosure to laws that required the taxing authorities to leave no stone unturned in trying to find the debtor.

At the heart of this range in statutes was the conflict in philosophies noted by the Commonwealth Court of Pennsylvania in 2007, *Fernandez v. Tax Claim Bureau of Northampton County,* construing Pennsylvania's elaborate scheme for locating the taxpayer.

The court wrote, "We have held that the primary purpose of the law is not to strip away citizens' property rights but, rather, to insure the collection of taxes. . . . In contrast, we must call attention to a statement made by the tax claim supervisor that the bureau's 'goal is to sell the property.'"

Other states, such as Michigan and Ohio, have schemes so elaborate to notify the taxpayer, that *Jones* is simply not an issue.

Jones is actually more solicitous of the states' needs to enforce their own tax laws than some states are for themselves. *Jones* shies away from "impos[ing] burdens on the state significantly greater than the several relatively easy options outlined." Some states don't see it as a burden; others do. *Jones* looked at the two sets of goals and tried to formulate a set of rules that took a middle path.

Contrary to commonly held belief, *Jones* nationalized an already common standard.

Of ostriches and ignorance

In post-*Jones* jurisprudence, we see two distinct threads. One thread is concerned with how much the government knew about the delinquent taxpayer and what it did with that knowledge; the other is concerned with what the delinquent taxpayer knew about the government and did with that knowledge.

The first thread deals directly with what *Jones* had to say about what it called the government's obligation to "consider unique information about an intended recipient." Interpretation of the governmental obligation on that question has been surprisingly diverse.

In 2007, in *County Collector v. Lowe,* Illinois saw no reason for the government to read what the postal carrier had written on the returned envelope and even less reason to act on it to look for the delinquent taxpayer. But in the 2009 case *State Treasurer v. Muhammand Development Group Inc.,* Michigan found the government's misplacement and misfiling of information that the delinquent taxpayer was elsewhere to be insufficient excuse for the Michigan authorities to fail to act on that information. (See also *Patricia Weingarten Assocs. Inc. v. Jocalbro Inc.,* Florida District Court of Appeals, 2008.)

In Florida in 2006, *Vosilla v. Rosado* found the chain of title invalid where the tax collector had twice been given the correct address for the delinquent taxpayer and had failed to have it entered on all of the governmental computer systems. It was a classic case of the right hand (or computer) not knowing what the left was doing.

The other thread is where, as in the 2009 decision in *Schelereth v. Hardy,* Missouri found that the delinquent taxpayer's willful refusal to pick up the certified mail was no excuse for the government not to try other means of notification.

Here, there are two levels of ignorance taking place. First, there is the delinquent taxpayer who may know that there is a certified piece of mail, but who does not know what is actually in that envelope. The second is that with the certified mail returned "unclaimed," the government has no way of knowing why the mail went unclaimed and therefore could not assume that the delinquent taxpayer was willfully ignorant.

Being honestly ignorant in its own right, under *Schelereth,* the government had to take the additional *Jones* steps, the underlying truth of the situation being essentially irrelevant.

Rote vs. Reason

Post-*Jones* case law develops a dichotomy between cases that look to *Jones* for a simple rule to follow, to apply mechanically, as by rote. The other side looks to the underlying reasoning of *Jones* and attempts to rule upon each

case on its facts, by reason.

For the title industry, the rote line is more comfortable. Underwriters like cold, hard facts—things such as what judgment was recorded when or what liens receive statutory priority.

However, *Jones* itself speaks against rote. The concept of "unique information" is inherently hostile to rote application of *Jones*.

Indeed, in 2006, in *Sidun v. Wayne County Treasurer*, Michigan required not just that the government take notice of what appears on the information that has come into the government's hands, but on what research leads that information obviously suggests. Under *Sidun*, the government is required to take an intelligent look at the unique information and see if it suggests other ways that can be used to contact the debtor. *Jones* itself is not that strict.

Under the rote version of *Jones*, if the taxing authority sends the notification to the delinquent taxpayer both by certified mail and by ordinary unrestricted first-class mail, it has done enough. Defying both logic and *Jones*, some cases will point to a multiplicity of certified mailings as being enough. If one certified mail fails, a bunch should do no better.

114 Tenth and the supposed exception to *Jones*

A 2007 New York case highlighting the title underwriters' discomfort with *Jones* is *NYCTL 1999-1 Trust v. 114 Tenth Ave. Assoc. Inc.*, in which the attack on the constitutionality of the notice came immediately after the foreclosure sale, but before the closing on that sale and its consequent deed.

When the successful bidder at the foreclosure sale was ready to actually close on the title, fully two years of bitter litigation had embroiled the parties in three different court systems, including the New York State court systems, bankruptcy court and the U.S. Supreme Court. All of this battle was over whether New York City's tax foreclosure procedure gave the delinquent taxpayer enough notice of the foreclosure under the requirements of the federal Constitution. Rather than enmesh itself in that battle, the title company at the foreclosure sale simply refused to insure against further litigation affecting the title.

However, while that dealt with the problem immediately before the parties in *NYCTL*, it also highlighted the threat posed to later purchasers by the *Jones* line of thought. If the title company questioning the security of this title were not the one at the foreclosure sale, but one further down the chain of title, it would have been far harder for the seller in that imaginary deal to defend the legitimacy of the title it was attempting to convey. That imaginary seller would have to hope that its lawyers could do enough research to convince the imaginary buyer or the imaginary buyer's title company that the earlier foreclosure was in keeping with constitutional standards.

However, one should realize that these foreclosures only create a problem when they are the result of the delinquent taxpayer not only defaulting on the taxes, but also defaulting on the foreclosure proceedings. If the delinquent taxpayer actually contested the foreclosure proceedings, any buyer down the chain of title can safely rely on the constitutionality of those proceedings.

Service of process

Thirty-four states and the District of Columbia permit substituted service by delivery of process to the state's secretary of state or other designated official, where the state official is designated an "agent" of the corporation for the purpose of receipt of the process.

Of the states permitting service on a governmental official, 29 follow a procedure in which the plaintiff delivers copies of the process to the official, and the official sends a copy of the process to the defendant by certified or registered mail at an address on file or provided by the plaintiff.

In six states, the plaintiff is required to file a copy of the process in the office of the state official, who sends a copy to the defendant by certified or registered mail. Under this scheme, the plaintiff is informed of the nondelivery of the process.

Under these state laws, with one exception, the official learns if the mailing is returned undelivered, but does not inform the plaintiff unless the plaintiff inquires. Where a foreclosing authority elects to use service on a governmental official to provide notice in any of these 28 states, the foreclosing authority does not learn whether the mailing of the notice is returned undelivered, and thus the foreclosing authority avoids its responsibility under *Jones* to act further to get notice into the property owner's hands.

Only in New York and West Virginia, when the secretary of state receives process, the secretary's office sends the process to the business entity by certified mail addressed to whatever address the secretary has on file.

Getting to know a person who actually desired to inform

Jones requires that a government act like a person who actually desired to inform, but gives no guidance as to what such behavior entails. Several states, either inspired by *Jones* or their own pre-existent public policy, have given substantial flesh to the bare bones of that idea.

Miner v. Clinton County (2008) gives an excellent glimpse of what would qualify. In it, the county treasurer received a mailing receipt with an illegible signature from the certified mail sent to the delinquent taxpayer.

"[The] county treasurer's office confirmed, by checking the United States Postal Service website, that the Notice was delivered . . . within the ZIP code applicable to the Tupazes' residence. After comparing the 'signature' on the . . . delivery receipt to previous delivery receipts for notices of foreclosure that had been sent to the [delinquent's] address, she concluded that previous notices had been accepted with equally indecipherable markings."

Such an affidavit satisfies *Jones*. *Miner* ruled that when a taxing authority reasonably concludes that notice has actually been received, it is sufficient under *Jones*.

Older foreclosures are not a problem

The only real problem is with recent tax foreclosures, because the kind of title flaw we are talking about—due

process—is one that is peculiarly susceptible to counter-arguments that whatever problems there were with service of process were either waived or the delinquent taxpayer waited too long to raise them.

Judges therefore only entertain challenges to a foreclosure raised reasonably diligently by the delinquent taxpayer, effectively not more than a few months after title has passed. No matter how badly constitutional rights are trampled, courts are unwilling to vacate their own judgments unless litigants move promptly (measured from when the defaulting litigant first learned or should have learned that something was amiss), and *Jones* is not retroactive.

With income-producing properties, the purchaser at foreclosure likely makes immediate contact with the current occupants, which should normally alert the delinquent to the realization the property was sold. The delinquent should then move promptly. Thus, the presence of a recent tax foreclosure presents a far greater hazard to insurable title than does an older one in the record. The old claim of violation of due process will go stale in a relatively small amount of time.

For non-income-producing property where there is no predictable signal to the delinquent taxpayer that title has been lost, it may be that the due process claim has as much as another year of viability. Absentees are expected to check in on even their non-income-producing property at least occasionally.

Title underwriters have to decide how old a tax foreclosure must be to deem title clear. Completely undeveloped land may prove the most difficult to insure because it is the land least likely to draw the owner's attention to something being amiss, thus being the least likely to raise the argument that the delinquent taxpayer waited too long to complain about the foreclosure procedure.

Repairing *Jones* gaps in chains of title

Under *Jones*, tax foreclosures create gaps in the insurable chain of title. But, in an affected transaction, the seller's and purchaser's attorneys will both want to find a way to clear that exception. The title insurer should accept certain proofs to do so.

The attorneys should first examine the court file for the foreclosure and determine whether the taxpayer participated in the suit. If there was any participation at all, there is no *Jones* violation to worry about.

Next, the seller's attorney will want to examine the court records showing what means the process server used to serve the court papers upon the delinquent taxpayer. If the process server used the most ordinary means, there is essentially nothing to worry about.

Going beyond the public record

If, however, service was by means that often actually fail to reach the delinquent taxpayer, the seller's attorney, purchaser's attorney and title company all have reasons to want to see this *Jones* gap repaired. They can achieve this by reasonably diligent means.

These efforts can include searching the court files for the foreclosure proceedings to see what, if any, references there are to what efforts were made to contact the delinquent taxpayer beyond the initial mailing; contacting the foreclosing taxing authority to see if the certified mailings or the return receipts came back; performing Internet searches to see if current mailing addresses for the taxpayer match those used in the foreclosure procedure; and visiting the property to see what information current occupants or neighbors can provide.

These research efforts can be set forth in an affidavit sufficient to satisfy the title underwriter that the delinquent taxpayer has indeed abandoned all further connection to the property.

Thus, one can overcome the *Jones* barriers to clear title. *Jones* weakened links in chains of title, but they can be strengthened by basic research and elementary due diligence. **MB**

Adam Leitman Bailey is the founding partner and Dov Treiman is a partner of Adam Leitman Bailey PC, New York. They can be reached at info@alblawfirm.com.

Don't lose the ability to do business.

WWW.CAMPUSMBA.ORG/SAFE

Deadlines in your state are approaching. Many are less than 30 days away.

As you know by now, there are new education requirements that you must complete this year in order to be licensed and continue originating loans. CampusMBA, the education division of the Mortgage Bankers Association (MBA) and an NMLS-approved training provider (Provider ID 1400036), is working hard to help you meet those requirements.

We currently have **ten NMLS-approved courses,** which are available in both **online and in-person formats,** including the first level of our signature School of Mortgage Banking (SOMB).

Visit CampusMBA SAFE Act Central at www.campusmba.org/SAFE to explore our NMLS-approved offerings that meet SAFE Act education requirements.

CampusMBA
Training Center for Real Estate Finance

10047