Buyers and Brokers Beware: The Contract-Deeding Trap for the Unwary

by Douglas R. Tueller and Nathaniel R. Smith

This article highlights potential title conveyance traps for unwary parties, brokers, and attorneys relying on conveyance instruction provisions in the Colorado Division of Real Estate-approved standard contract forms.

A primary aim of the Colorado Division of Real Estate Form Contracts (Form Contracts) has always been to assist parties involved in day-to-day Colorado real estate transactions.[1] These documents are intended to help unsophisticated parties proceed with day-to-day transactions without needing to engage legal counsel, except when specific legal complications arise.

The Form Contracts generated over the years have served these goals, especially in the context of simple residential and land transactions. However, Section 13 creates a potential trap for the unwary and uninformed in day-to-day real estate transactions—especially in the residential context.

This article identifies the practical problems attending Section 13 of the Form Contracts (Section 13) and the title insurance customs that have developed around its language. The article then discusses and recommends some protective steps that real estate brokers and legal counsel can take to help ensure that clients achieve their transactional goals using the forms.

The Section 13 Form Contracts Dilemma

The primary consideration with Section 13 is its mandate directing that deeds prepared by escrow agents (and used by the title companies issuing title insurance) specify exceptions to title conveyed at closing in accordance with Sections 13.1 and 13.3. Those provisions of Section 13 are:

> *Except as provided herein, title will be conveyed* free and clear of all liens, including any governmental liens for special improvements installed as of the date of Buyer's signature hereon, whether assessed or not. Title will be conveyed *subject to*:
>
> **13.1.** *Those specific Exceptions described by reference to recorded documents as reflected in the Title Documents accepted by Buyer in accordance with* ***Record Title****,*
>
> **13.2.** Distribution utility easements (including cable TV),
>
> **13.3.** *Those specifically described rights of third parties not shown by the public records of which Buyer has actual knowledge and which were accepted by Buyer in accordance with* ***Off-Record Title*** *and* ***New ILC or New Survey****,*
>
> **13.4.** Inclusion of the Property within any special taxing district, and
>
> **13.5.** Any special assessment if the improvements were not installed as of the date of Buyer's signature hereon, whether assessed prior to or after Closing, and
>
> **13.6.** Other _____.[2] (Emphasis added.)

The emphasized language of Sections 13.1 and 13.3 provides specific directions to closing and title agents that the seller is to convey title at closing subject to the referenced pre-closing contract events, which refer entirely to off-record matters. Thus, absent closing instructions to the contrary, this emphasized language has resulted in a course of closing customs in which parties without sufficient legal or title advice automatically direct the escrow and title agents to convey title subject to off-record title exceptions. These default directions result in title being conveyed in that manner, with unsophisticated parties not having any real appreciation of how this language will affect the title so conveyed. Because the parties often do not involve attorneys in day-to-day simple residential real estate transactions (especially low-value ones), unintended consequences can result.

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Specific Section 13 Issues

The following types of issues may arise in property conveyances.

The "Off-Record" Title Exception Dilemma

Real estate practitioners must consider Section 13 (specifically Sections 13.1 and 13.3) in relation to CRS § 38-35-108 (Off-Record Statute), which clarifies that deeds or other conveyance documents

> shall bind only the parties to the instrument and shall not be notice to any other person whatsoever unless the instrument mentioned or referred to in the recital is of record in the county where the real property is situated. Unless the same is so recorded, no person other than the parties to the instrument shall be required to make any inquiry or investigation concerning such recitation or reference.[3]

As a practical matter, when the escrow agent drafts and submits to the parties at closing a deed using the Section 13 mandated off-record exceptions to title (Section 13 Exceptions) in a form similar to that provided on the Warranty Deed (Form 1; see sample form at the end of this article), two specific problems arise. First, by excepting such off-record Section 13 Exceptions, the actual warranties of title given by the seller to the buyer at closing are unclear and cannot be ascertained by simple reference to the recorded deed. This situation forces all parties to rely on their personal record-keeping in perpetuity, the impacts of which are discussed below. Second, the Off-Record Statute effectively limits the title warranties conveyed in deeds subject to the off-record Section 13 Exceptions to only the grantor and grantee. Therefore, by excepting title in the manner mandated by Section 13, the parties effectively limit their warranties of title to themselves only, thereby possibly precluding these from running with the land to the benefit (or burden) of subsequent heirs, successors, and assigns.[4]

The "Race-Notice" Issues

An additional consideration arises for subsequent grantees by virtue of Colorado's race-notice rule contained in CRS § 38-35-109(1) (Race-Notice Statute). The Race-Notice Statute states, in pertinent part, that

> [n]o such unrecorded instrument or document shall be valid against any person with any kind of rights in or to such real property who first records and those holding rights under such person, except between the parties thereto and against those having notice thereof prior to acquisition of such rights. This is a race-notice recording statute.

Under the Race-Notice Statute, conveyed rights or title warranties limited by the Section 13 Exceptions (including those between the original grantor and grantee) may not withstand claims asserted by parties subsequently recording contracts, instruments, or documents affecting title. Unless the title-vested party can prove that the subsequently recording party had actual knowledge of the off-record matters referenced by the Section 13 Exceptions, claims based on such subsequently recorded instruments could likely succeed. In other words, by subjecting the conveyed title to the Section 13 Exceptions, the original grantor and grantee expose all subsequent successors, heirs, and assigns (and possibly themselves) to adverse title claims by good faith or bone fide parties recording documents with provisions contrary to any of the off-record Section 13 Exceptions.

Issues Involving Other Pertinent Statutes

These Off-Record Statute and Race-Notice Statute considerations are exacerbated by the fact that the Section 13 Exceptions are subject to the actual purchase contract between the original grantor and grantee. Thus, in addition to requiring that later interpretation of title warranties reference off-record exceptions, the Section 13 Exceptions may also require subsequent review of other off-record contract rights and obligations of those original contracting parties.[5]

These considerations with both the Off-Record and Race-Notice Statutes also appear to apply irrespective of the provision of CRS § 38-30-121 regarding covenants of title running with the land and impacting subsequent purchasers and encumbrances (Title Covenants Statute). Despite the provisions of the Title Covenants Statute, the limitations on title covenants mandated by the Section 13 Exceptions do not alleviate the challenges created by the Section 13 Exceptions for subsequent parties seeking to interpret the nature of covenants running with the land but limited by or conditioned on off-record matters.[6]

Similarly, the Section 13 Exceptions issues do not go away even if the contracting parties use the statutory form of deed contemplated and approved in CRS § 38-30-113, because Section 13 still technically mandates that the deed reflect the Section 13 Exceptions. As a result, if parties use this statutorily-approved form of deed without modifying the deed to reference the off-record Section 13 Exceptions (as remains customary for many title companies), then title warranty issues still exist in connection with the Form Contracts.

Escrow and Title Company Issues

Practitioners should consider the practices of escrow and title companies in connection with the Section 13 Exceptions.

➢ ***Escrow agent concerns.*** When escrow agents prepare and tender deeds with the Section 13 Exceptions to parties not represented by competent legal counsel, a number of questions arise. The first of these relates to whether anyone in such transactions (whether brokers, title companies, or escrow agents) adequately explains to the parties the potential adverse title consequences of such deeds. The second concern (which often arises even when counsel is involved) relates to the escrow agents' obligations to

retain documentation of the off-record Section 13 Exceptions and the parties' approvals of these records. Because escrow agents' records often prove to be the most reliable source for reconstructing Section 13 Exception off-record matters, the duties of escrow agents take on particular significance in this context. Such duties also raise questions, for example, as to how long escrow agents need to retain records and the extent of the escrow agents' documenting obligations at closing.[7]

➢ ***Title company interests.*** With respect to title companies, the same set of possible obligations and liabilities regarding duties to explain title issues (including possible unlicensed practice of law concerns) and record-keeping exist as for escrow agents.[8] An additional concern arises from the policies adopted by title insurers over the years to protect title abstracting information generated to produce title commitments, which they assert is proprietary.

To the extent that the Off-Record Statute limits warranties of title to the original grantor and grantee, it appears that title insurance liabilities to successors, heirs, and assigns for breached warranties of title may be limited, if not entirely removed. However, these limits are complicated by the possible duties of title companies to disclose the consequences of these limited warranty coverages to parties and heighten their efforts to maintain adequate records, as discussed above.

From a title underwriting perspective, limiting warranties of title to avoid warranties that run with the land appears to render a result that favors title companies, but this may not always be the case.[9] The same result holds true with respect to title risks arising under the Race-Notice Statute. However, as a practical matter, title underwriting costs and liability exposure could increase to the extent that the Section 13 Exceptions create ambiguity or the need to establish the parties' actual prior notice.

Real Estate Broker Issues

This situation also raises a number of potential issues for real estate brokers, especially in the context of simple, low-value residential transactions in which the parties do not hire legal counsel. In light of the legal and title problems discussed above, questions arise as to whether brokers expose themselves to liability in transactions in which the parties did not engage legal counsel, the broker made inadequate disclosure of the issues, or subsequent problems arise as a result of deeding with the Section 13 Exceptions (especially for the buyer's successors, heirs, or assigns). It is unclear how prevalent such instances ultimately might become, but it is important for brokers and other real estate professionals to understand these liability issues to adequately protect their own as well as their clients' best interests and needs.[10]

Examples of Section 13 Problems

The following examples pose hypothetical (and hopefully not common) factual situations. They are meant to illustrate instances in which highly complex and difficult warranty, race-notice, and other issues can arise in day-to-day transactions that may be complicated by the Section 13 Exceptions.

Scenario One: The Successor Neighbor Dilemma

Grantor owns two lots in a residential subdivision that abut each other and are bound on the north and east by city streets, with an internal private subdivision to the west. Grantor decides to sell Lot 2 (the vacant easterly lot) and keep Lot 1 (the westerly lot), where he lives in his long-time residence. Grantor lists Lot 2 with a listing broker, who then works with her co-agent selling broker to sell Lot 2 to the grantee.

The brokers assist the parties to enter into a Standard Form Contract, with no modifications of Section 13. The transaction goes smoothly, with grantee obtaining an Improvement Location Certificate for Lot 2 (ILC) thereby obtaining extended title insurance, with no exceptions for legal access.

In his due diligence, the grantee confirms with the grantor that he will be able to use the gravel driveway access to Lot 1 depicted on the ILC to provide access from Lot 2 to the subdivision road to the west. While the recorded subdivision plat only reflected a utility easement in the location of the driveway shown on the ILC, the parties and brokers are all satisfied with that reference and grantor's assurances.

The escrow agent prepares and tenders a general warranty deed in the standard form directed by the title company (a copy of which is attached thereto as Form 1), the parties close the transaction, the brokers get paid their commissions, the title company issues its title policy for Lot 2, and everyone is happy.

Two years later, grantor conveys Lot 1 to his daughter, grantor's successor, using the same form of deed and the same escrow and title company, but no broker. Five years after that, the grantee decides to retire and sells his home and Lot 2 to the grantee's successor, using the listing broker as his listing and selling agent. The grantee's successor then promptly constructs a 10-foot block wall around the perimeter of Lot 1 to enclose his pack of wolfhounds. One year later, the grantor's successor decides to construct a home on Lot 1 and is informed that the grantee's successor has no intention of allowing her to breach his walls and to construct a driveway across Lot 1. This leaves the grantor's successor facing a new access onto the county road to the east that now has been improved to a four-lane major traffic artery, with a new six-foot sidewalk and gutter improvements recently installed at great cost by the city.

The grantor's successor now talks to her attorney and seeks help. The attorney makes a demand on the grantee's successor to provide the driveway access, as promised and believed to be conveyed by the grantor to the grantee. The attorney also tenders a title claim to the title company, based on warranties of title in the deed from the grantee to the grantee's successor and the title insurance issued therewith. The attorney also makes a demand on the selling broker, as the grantee's initial broker.

The grantee's successor hires his own attorney, who promptly responds with a claim against the listing broker and the title company and responds to the claims asserted by counsel for the grantee's successor with a letter referencing her deed and indicating that the grantor's successor took title with no constructive or actual knowledge of any access claims by the grantee's successor or relating to Lot 2.

The title company responds to both the grantee's successor and the grantor's successor with a denial of any liability, based on the deeds recorded for all the conveyances and the title policies issued together therewith. Furthermore, the title company indicates that all of the escrow agent's records relating to the closing were misplaced during a recent office relocation.

Litigation results for everyone involved, and no one is happy.

Scenario Two: Who's on First?

The grantor owns Lots A and B, which abut each other. The grantor lives in a house located on Lot A and decides to sell both lots, but is concerned about protecting the view to the Lot A house. The grantor thus identifies a portion of Lot B that he wants to keep open from construction, despite recognizing that it is a prime location for a house on Lot B. While he recognizes that the value of Lot B could be reduced drastically by his desired no-build zone restriction, on balance he recognizes that the value increase for Lot A will outweigh the Lot B devaluation.

The grantor engages a listing broker to sell both lots, who then obtains a contract from the Lot A buyer through the buyer's selling broker. The contract references the parties' intention to agree on a no-build zone on Lot B, as part of the due diligence. The parties obtain an ILC for Lot B, which reflects the no-build zone in the location the surveyor understood was agreed to by the parties to be encumbered prior to the Lot A closing.

A no-build zone covenant document was drafted and agreed to by the grantor and the Lot A buyer and delivered to the escrow agent, but it was never signed or recorded. After the grantor signs the contract to sell Lot A to the Lot A buyer, the listing broker receives an attractive "quick sale" contract from the Lot B buyer for Lot B. The grantor enters into another contract to sell Lot B to the Lot B buyer, which closes prior to the grantor's closing on the Lot A contract, with minimal due diligence and no survey. The sale of Lot A to the Lot A buyer closes a week later, with the no-build-zone covenant being recorded in connection with that closing and being listed on the Lot A buyer's title policy, as both an exception to and as part of the insured estate.

Both transactions used the Form Contracts, each with an unamended Section 13. Both deeds reflected the Section 13 Exceptions, in the form attached thereto as Form 1, and the same escrow and title companies and agents closed both transactions.

Ten years later, the Lot A buyer sells Lot A to buyer A-1, using the same contract and deed forms and escrow and title companies, with buyer A-1 obtaining a new title policy listing the no-build covenant as both an exception to title and part of the insured estate. Two years after that, the Lot B buyer decides to sell Lot B and obtains a pro forma owner's title commitment from the same title company reflecting the no-build covenant as an exception to title. In the meantime, the grantor has died and his probated estate is closed.

Upon receiving the new pro forma title commitment, the Lot B buyer tenders a title claim on the title company, based on the initial Lot B title policy and also makes a demand on Buyer A-1 to release the burden of the no-build covenant. Buyer A-1 then files a title claim against the title company based on its deed from the Lot A buyer, who then similarly files a title claim against the title company on his title policy issued on his Lot A deed from the grantor. The title company, in turn, denies coverage to all the claims, in part on the basis of the Section 13 Exceptions contained in each of the deeds.

Possible Solutions

Real estate practitioners can take a number of simple protective measures to help ensure that unintended problems do not arise for their clients, such as:

1. Add to Section 13.6 the following: "All items in Paragraph 13.1–13.5 above, inclusive, shall be reflected on an exhibit to the deed delivered at Closing." This or similar additional language should provide sufficient instructions to the escrow and title agents preparing deeds to ensure they take adequate steps to achieve the contracting parties' goals and needs. This is possibly the best and most straightforward step.
2. Add language to Section 13.6 directing the escrow and title agents to prepare a deed to include a legal description and exhibits referencing all title documents benefitting and burdening the property.
3. An alternative approach (probably most attractive to sellers) could include ensuring that the deeds delivered at closing are drafted to except all matters referenced in the public records.

Conclusion

The Form Contracts, by and large, successfully provide a standardized form that proves very useful for most simple, day-to-day residential transactions. But real estate practitioners must consider Section 13 of the Form Contracts in conjunction with various statutory provisions to guard against unintended consequences.

Notes

1. The Form Contracts include the Contract to Buy and Sell, Residential; Contract to Buy and Sell, Income-Residential; Contract to Buy and Sell, Commercial; Contract to Buy and Sell, Land; and Contract to Buy and Sell, Colorado Foreclosure Protection Act. These are available at www.colorado.gov/pacific/dora/division-real-estate-contracts-and-forms. The Forms Committee is currently taking suggestions related to the Forms Contracts. Such suggestions can be made at www.colorado.gov/pacific/dora/division-real-estate-contracts-and-forms; under "Resources," click on "2016 Colorado Real Estate Commission Forms (suggestion Form)."
2. Form Contracts § 13.
3. *See also* CRS § 38-30-121.
4. This problem is distinct from provisions in the Form Contracts that address obligations of the parties relative to off-record matters disclosures. These relate to actual off-record matters that normally would not be expected to impact or limit the title conveyances reflected in the deed at closing. Thus, the provisions and procedures for those off-record matters are distinguishable from the concerns raised in this article.
5. This also raises questions as to whether such contract rights actually may merge into the deed at closing. Such considerations are beyond the scope of this article.
6. This implicates the same concerns stated in note 4, *supra*.
7. This also raises questions as to the extent of duties or liabilities of escrow agents to the parties in this context, including possibly as fiduciaries. *See* 2 Palomar, *Title Insurance Law* § 20:3 (West Group, 2010) (stating that a closing escrow agent "is considered to be the agent of all the parties to the real estate transaction and, in most jurisdictions, bears a fiduciary relationship to each party").
8. *Id. See generally Conway-Bogue Realty Inv. Co. v. Denver Bar Ass'n*, 312 P.2d 998 (Colo. 1957) (discussing that title companies are one of many parties that act as scriveners for listing brokers in preparing deeds for transactions). *See also Title Guaranty Co. v. Denver Bar Ass'n*, 312 P.2d 1011 (Colo. 1957) (continuing the discussion set forth in *Conway-Bogue Realty Inv. Co.*).
9. If for no other reason, title companies should benefit in those instances from a smaller pool of potential title insurance policy claimants.
10. Understanding the so-called *Conway-Bogue* standard, allowing title companies to prepare deeds and charge the listing broker as a scrivener for the transaction, is especially important. *See* note 7, *supra*. Practitioners should note the resources available on the CBA Real Estate Section's webpage, which include a listserve, www.cobar.org/index.cfm/ID/20155/REALES/Real-Estate. ■

Form 1

Warranty Deed

(Pursuant to 38-30-113 C.R.S.)

THIS DEED, made on _____ by _____ Grantor(s), of the County of _____ and State of _____ for the consideration of (_____) _____ dollars in hand paid, hereby sells and conveys to _____ Grantee(s), Tenancy whose street address is _____, County of _____, and State of _____, the following real property in the County of _____, and State of Colorado, to wit:

also known by street and number as: _____

with all its appurtenances and warrants the title to the same, subject to *general taxes for the year _____ and those specific Exceptions described by reference to recorded documents as reflected in the Title Documents accepted by Grantee(s) in accordance with Record Title Matters (Section 8.2) of the Contract to Buy and Sell Real Estate relating to the above described real property; distribution utility easements, (including cable TV); those specifically described rights of third parties not shown by the public records of which Grantee(s) has actual knowledge and which were accepted by Grantee(s) in accordance with Off-Record Title Matters (Section 8.3) and Current Survey Review (Section 9) of the Contract to Buy and Sell Real Estate relating to the above described real property; inclusions of the Property within any special tax district; and other*

_____

_____

_____

_____

State of)
) ss.
County of)

The foregoing instrument was acknowledged before me on this day of _____
by _____

_____
Notary Public
My commission expires _____

When Recorded Return to: _____
_____