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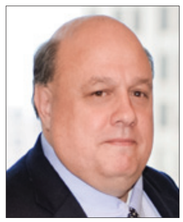
Supreme Court Annuls Agency Overreach In Title Insurance Regulations



By **Tancred Schiavoni**

And **Gary Svirsky**

On October 18, 2017, New York Department of Financial Services Superintendent Maria Vullo adopted a regulation that made it harder for people to buy homes. The superintendent, who is authorized to regulate insurance, burdened the market for title insurance, which people need when purchasing or refinancing real estate with a mortgage. Banks simply will not lend money without this essential product because title insurance provides coverage for the risk that the seller does not own the property he or she is selling. Regulation 208 broadly barred basic marketing practices that are common in most service industries, such as taking business associates for dinner or to a ball game. In doing so, this regulation impaired the work of insurance companies that cover the risk of loss, agents who sell title policies and closers who do the actual closing work.

Given the importance of land title insurance, insurers mounted a legal challenge, and on July 5, in a detailed decision, Justice Eileen Rakower of New York State Supreme Court corrected the superintendent's overreach when she granted an Article 78 petition to strike down this regulation. She held that to prohibit title insurance companies from marketing their business would be an "absurd proposition." Annulling a regulation in its entirety, as the court did here, is a rare remedy and highlights the superintendent's excess. But the matter may not be over as the superintendent has announced that she intends to appeal.

> It is "common sense that marketing is an inducement for business." To prohibit title insurance companies from marketing their business would be an "absurd proposition."

DFS' Regulations Imposed Strict New Requirements

In a press release accompanying Regulation 208, the superintendent stated that the "industry has improperly charged back to consumers marketing costs" for title insurance. Oct. 17, 2017, "DFS Announces Final Regulations To Combat Unscrupulous Practices In The Title Insurance Industry," at https://www.dfs.ny.gov/about/press/pr1710171.htm (last viewed on July 31, 2018). The superintendent imposed this regulation under the auspices of Insurance Law Section 6409(d), which prohibits title insurers, insurance agents or anyone acting for them from offering or accepting *quid pro quo* inducements to sell title insurance, which is a basic anti-kickback provision. There were three specific challenged provisions.

First, Section 228.2(b) prohibited

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title insurers and agents from giving consideration to third parties for referring business, and defined outings, entertainment, and parties as unlawful inducements. The provision also allowed political and charitable contributions and advertising expenses only so long as they were "reasonable and customary." Second, Section 228.3(c) required title insurers to (i) confirm that no expense schedule they submitted to DFS for approval in the past six years included an unlawful expenditure, (ii) restate their expense schedules for the past six years to exclude unlawful expenditures, or (iii) accept a 5% reduction in their premiums. Third, section 228.5 capped ancillary fees and prevented title closers from receiving gratuity or a pick-up fee from insureds.

Title insurers Challenged The Regulations

Title insurers petitioned the New York State Supreme Court to annul the regulations, arguing that the DFS exceeded its statutory authority in ways that were inconsistent with Insurance Law 6409(d). They raised four arguments:

First, Insurance Law Section 6409(d) on which Regulation 208 is based, only prohibits title insurers or agents from offering any portion of their fee, premium or commission "as an inducement for, or as compensation for, any title insurance business." Ins. Law § 6409(d). As the terms "fees," "premium" and "commission" share no identity with entertainment or marketing expenses, Section 6409(d) itself makes clear that entertainment and marketing expenses are not illegal under the statute, particularly when they are not exchanged for a specific piece of title insurance business. These marketing activities (typical in other service industries) were not inducements but were intended to build business relationships.

Second, DFS acted arbitrarily by reversing its own longstanding precedent. The petitioners cited several DFS decisions holding that ordinary marketing and entertainment expenses did not previously constitute an inducement, "so long as there is no quid pro quo arrangement." Brief for Petitioners, at 27 citing (OGC Opinion Nos. 2002-290 (Nov. 13, 2002), 2005-284 (Nov. 10, 2005), and 11-05-04 (May 31, 2011)).

> While the legislature can enact or change statutes, the superintendent must stay inside her democratically fenced-in domain.

Third, DFS violated market participant's due process rights. It effectively mandated a retroactive 5% premium reduction as a penalty for past marketing practices without giving fair notice that the prohibited conduct was illegal.

Finally, the regulation was impermissibly vague and thus unconstitutional because it did not give market participants reasonable notice of what constitutes "lavish or excessive" advertising or charitable and political contributions. And the regulation chilled the First Amendment right to donate to political and charitable organizations and advertise services without having been narrowly tailored to the desired goal.

DFS Claimed Regulation 208 Would End Unfair Consumer Pricing

The superintendent claimed the regulations would protect consumers by ending the practice of using meals and entertainment as an inducement for title insurance business. This would save buyers money by ensuring fair closing costs and making sure that consumers "will know exactly what they are paying for during the closing process." Oct. 17, 2017, "DFS Announces Final Regulations To Combat Unscrupulous Practices In The Title Insurance Industry," at https://www.dfs.ny.gov/about/press/pr1710171.htm (last viewed on July 31, 2018).

DFS argued that Insurance Law Section 6409(d), the "anti-inducement statute," nowhere mentions the requirement of a *quid pro quo* for specific title insurance business. Rather, the statute bars insurers and agents from giving consideration to others to induce "*any* title insurance business." Emphasizing the word "any," DFS argued that entertainment expenses could qualify as an inducement.

As for the 5% premium penalty,

title insurers may reevaluate their expenses to exclude illegal inducement and thus avoid the penalty. While DFS acknowledged that this was burdensome, because the law already requires title insurers to maintain expense records for six years, it is feasible to reassess these records. And even if insurers were compelled to accept the 5% premium reduction, petitioners have no "vested interest" in keeping their premiums at the current rate, thus the penalty does not implicate due process rights. In any event, DFS maintained that the penalty was not "retroactive" because it applied to future rates based on past expenses. The 5% premium reduction was supposedly statistically sound because it was based on DFS studies showing that inducements accounted for a 5% increased premium.

Regarding the First Amendment arguments, Section 228.2 applies only to expenditures made as "inducements" so it regulates conduct, not speech. And even if the regulation were found to regulate speech, it advanced a substantial state interest by prohibiting inducements that harm consumers through higher premiums.

Justice Rakower Annulled Regulation 208

Justice Rakower focused on the statute, analyzing whether it "intended to prohibit marketing and entertainment expenses," as opposed to *quid pro quo* inducements in Insurance Law 6409(d). Slip Op. at *6. She considered specifically whether the language "other consideration or valuable thing," captured marketing expenses. When determining how to define "other consideration or valuable thing," the court construed the term in relation to the other terms around it, such as "rebate," "fee," "premium," "charge" and "commission." None of these terms was akin to "ordinary marketing and entertainment expenses." *Id.* at *7. Even the title of Section 6409—"commissions and rebates prohibited"—supported the court's reading that this statute did not intend to restrict marketing and entertainment. *Id.* Justice Rakower also looked to Second Circuit precedent holding that Section 6409(d) "bans the payment of commissions." *Id.* (quoting *Dolan v Fidelity Nat. Title Ins. Co.*, 365 Fed. Appx. 271, 275 (2d. Cir. 2010)).

Justice Rakower's review of the legislative history supported her conclusion—that Section 6409(d) prohibited "rebates and commissions, not ordinary marketing and entertainment expenses." *Id.* at *6. Indeed, the purpose of the bill was to "permit reduction in the cost of title coverage by barring payment of commissions to attorneys or real estate brokers by title insurers; prohibiting the receipt of any commission or rebate as an inducement for the placement of title insurance business." *Id.* at *6. It would be incorrect to consider the Insurance Law in any other light because "it is common sense that marketing is an inducement for business" and, the court logically concluded, to prohibit title insurance companies from marketing their business would be an "absurd proposition." *Id.*

As for the 5% premium reduction, the court annulled that provision without reaching whether retroactive penalties violate due process. The court relied on its broader conclusion that the targeted marketing expenses are not illegal under the statute. The court also annulled part of the regulation that prohibited in-house title insurance closers from accepting gratuities or pick-up fees during closing because a carve-out that allowed independent title insurers to accept or impose those costs made the provision "internally inconsistent," irrationally favoring outside over in-house closers. *Id.* at *12.

Conclusion

If the DFS superintendent wishes to enact a regulation to address some evil—real or imagined—then that is a judgment call. One may disagree with that call, but so long as it is within the ambit of her authority, then she is entitled to make it. But if that regulation goes beyond the superintendent's authority—as was the case with Regulation 208—then that is a different matter. While the legislature can enact or change statutes, the superintendent must stay inside her democratically fenced-in domain.