



## Who bears risk of loss after escrow agent defalcation?

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*Court Report*

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The Court of Appeals of Washington recently determined who bore the risk of loss after an escrow agent absconded with the escrow funds before the escrow conditions were satisfied. The trial court had concluded the borrower bore the risk and dismissed the borrower's claims against the lending entities, and the borrower appealed.

The case is *Tang Real Estate Investments Corp. v. Escrow Services of Washington, Aurora Lynn Rivera, Kiavi Funding Inc., Select Portfolio Servicing Inc., and Citibank NA, a subsidiary of Citigroup Inc., as trustee of COLT 2022-2 Trust (Court of Appeals of Washington, No. 84620-5-1)*.

Tang Real Estate Investments Corp. sought to refinance transactions for two of its properties, one in Seattle, Wash., and the other in Everett, Wash. It had preexisting loans for these properties from Level Capital and Kiavi Funding Inc., respectively. For both transactions, Escrow Services of Washington (ESW) was to perform all closing and escrow services, including satisfying all existing liens as a condition precedent to closing on new loans with Kiavi. The complaint states that instead, Aurora Lynn Rivera (ESW's sole escrow agent) utilized the funds for her personal benefit and interest.

After ESW failed to follow the closing and escrow instructions, Tang transferred the loan servicing operations for the Seattle property to Newrez LLC d/b/a Shellpoint Mortgage Servicing, which then transferred the operations to Select Portfolio Servicing Inc. Select Portfolio provided loan servicing operations for this loan for Citibank NA, which currently owns the note. For the Everett property, Kiavi transferred the loan servicing operations to Newrez.

Tang initially sued ESW and Rivera before amending its complaint to add claims against Kiavi, Newrez, Select Portfolio, and Citibank. The complaint alleged claims against these successor financial respondents for breach of contract, professional negligence, and declaratory relief. These claims are premised on the argument that Kiavi and the successor financial respondents bore the risk of loss of the escrow funds at the time Rivera absconded with the funds.

The financial respondents moved to dismiss the claims against them, arguing that Tang bore the risk of loss of the escrow funds at the time the funds were stolen because Tang selected ESW to provide escrow services. The trial court agreed with them and granted their motions to dismiss. Tang appealed.

The appellate court reversed the trial court's decision, finding it failed to correctly apply controlling case law.

"Where, as here, escrow funds are embezzled prior to the closing of the escrow, the controlling legal principles are set forth in a trio of cases: *Lechner v. Halling*, *Lieb v. Webster*, and *Angell v. Ingram*," the court stated. "Although our Supreme Court decided these cases several decades ago, they remain good law.

"The trial court here failed to properly apply *Lechner*, *Lieb*, and *Angell* when it granted Kiavi's motion to dismiss. In its complaint, Tang alleged that ESW 'failed to satisfy Kiavi's detailed prerequisites for closing,' 'failed to satisfy other

necessary conditions precedent,' 'did not complete and failed to follow the detailed closing instructions of Kiavi regarding the 8329 44th Avenue South loan and the 3226 102nd Place SE loan,' and other similar allegations," the court stated. "Given these allegations, which we accept as true for purposes of deciding whether the trial court erred in granting Kiavi's motion to dismiss, ESW had not yet completed the applicable escrow instructions — which included satisfying the preexisting loans — and was therefore holding the escrow funds as an agent of Kiavi at the time Rivera absconded with the funds. It necessarily follows, under *Lechner, Lieb, and Angell*, that Kiavi must bear the risk of loss. The trial court thus erred in dismissing Tang's claims against Kiavi.

"The trial court also erred in dismissing Tang's claims against the successor financial respondents," the court continued. "Our Supreme Court's opinion in *Dahlhjelms Garages, Inc. v. Mercantile Ins. Co. of America* is controlling on this point. The court in *Dahlhjelms* held that where an assignee of a contract exacts and accepts payments under the contract, they thereby 'assume[] the corresponding duty to perform the conditions the contract imposed as a consideration for their payment.' Here, according to the complaint, Citibank is 'the current owner of the note' for the 8329 44th Avenue South property and Newrez and Select Portfolio are responsible for loan servicing operations for one or both of the properties. It can therefore be hypothesized — as CR 12(b)(6) permits — that the successor financial respondents accepted payments under the new loans relating to the two properties and thereby assumed the risk of loss of the escrow funds under *Lechner, Lieb, and Angell*."

Kiavi argued that *Lechner, Lieb, and Angell* are distinguishable because they involve a purchase transaction rather than a refinance. The court disagreed.

"Next, Kiavi and the successor financial respondents argue that Tang must bear the risk of loss because it selected ESW and entrusted it with the escrow funds, which enabled it to perpetrate the wrong at issue," the court stated. "*Angell* is controlling on this point. In *Angell*, Ingram agreed to purchase Angell's residence, and Angell then hired Webster, an escrow agent, to facilitate the sale of the property. Although Angell selected and retained Webster, our Supreme Court held that the risk of loss rested with Ingram because Webster held the escrow funds as Ingram's agent when he absconded with the money. As *Angell* confirms, Tang's selection of ESW to provide escrow services for the refinancing transactions at issue here is immaterial to our analysis.

"Lastly, because we hold the trial court erred in granting the motions to dismiss, we need not address Tang's further argument that the trial court abused its discretion when it dismissed Tang's claims without granting leave to amend the complaint to add claims for unjust enrichment and contract rescission," the court stated.



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