

SUPREMES SPEAK. I LISTEN. SO SHOULD YOU.



COUNSEL'S CORNER

And yet here's more from the Texas Supreme Court regarding commercial property. This one shocked me and I suspect you'll be hearing / seeing / reading more about it.

Jay Cohen, trustee of various trusts, transferred several properties owned by the trusts into different partnerships. One involved the "West Newcastle" property, which Cohen transferred to Flat Stone II, Ltd. The controlling shareholder of Flat Stone's general partner, Matthew Dilick, gave Regions Bank a mortgage to secure a personal loan.

When the loan wasn't repaid because Dilick defaulted, Dilick transferred a piece from the West Newcastle property to a new entity. Cohen sued Dilick, alleging a fraudulent transfer and that Dilick lacked authority to mortgage the parcel. Cohen also filed notices of "litigation pending" (lis pendens) on the various pieces of property involved in the lawsuit.

One of the Notices of Lis Pendens stated that the purpose of the underlying suit was to invalidate the transfer of property and Regions Bank lien. The trial court granted the Dilick's motion to *expunge* the Notices of Lis Pendens.

While Cohen was appealing the Expunction Order, Dilick sold one of the parcels to Sandcastle for \$750,000.

Meanwhile the Texas court of appeals overturned the trial court's Expunction Order, so Cohen added Sandcastle as a defendant to cancel its recent purchase. When Dilick sold another piece to NewBiss for \$1.8 million, Cohen added NewBiss as a defendant to the same litigation.

And now to the important part: Both Sandcastle and NewBiss claimed that they lawfully relied on the trial courts *Expungement* Orders, which had the effect of voiding any notice derived from the Lis Pendens.

The trial court agreed that the *Expungement* Orders superceded the Notice of Lis Pendens, and that such Notices were void. That was the first win for Sandcastle and NewBiss. Cohen appealed.

The Texas Court of Appeals agreed with the trial court. That was the second win for NewBiss and Sandcastle. An appeal to the Texas Supreme Court followed.

At our State's highest Court, Cohen argued that expunction of the Notices of Lis Pendens does *not* relieve a purchaser from the duty to review the underlying lawsuit to determine if it could impact future ownership. NewBiss and Sandcastle defended by stating the obvious: that is what the word "*expunction*" means, to remove from a record, erase or destroy.

The Supremes decided that, no, the word "*expunction*," at least in the context of Notices of Lis Pendens, does not mean what we think it means. Rather, the word means that although the chain of title may be free from the recorded Notice, the *E word* does not have the affect of ignoring the underlying lawsuit altogether.

The Texas Supreme Court reversed the Judgment of the court of appeals and trial court. NewBiss and Sandcastle lost this last round and are now charged with knowledge of the contents of a lawsuit they believed was no longer relevant due to the Expunction Orders. See *Sommers v. Sandcastle Homes and NewBiss Property.*; Case No. 15-0847; Texas Supreme Court; June 16, 2017: <http://cases.justia.com/texas/supreme-court/2017-15-0848.pdf?ts=1497621851>.

Lessons learned:

1. The implication of this case is far-reaching. This means that if a Notice of Lis Pendens has ever been filed (even though later released / discharged / expunged), purchasers, tenants and lenders are still charged with understanding what was contained in the Notice as well as the underlying lawsuit. This appears to be the case even though after release / discharge / expungement, the Notice would not typically appear in a commitment for title insurance.
2. If a purchaser, tenant or lender fails to review the Notice (again, even though it's been released), the purchaser / tenant / lender may find itself defending a claim regarding fraudulent transfer or other legal issue. And, the title insurer may refuse to defend or indemnify claiming that the Notice (even though released) was a matter of public record, accessible to anyone who looked for it online.
3. Our Texas legislators will need to fix this when they next meet. In 2019. We'll need new laws to the effect that the word "*expunge*" means exactly what we

think. Otherwise and until that happens, smart buyers, lenders and tenants will need to instruct title agents to specifically search for all Notices of Lis Pendens affecting the target property, even though they may appear to have been subsequently released. Because a recorded Release – and I’m struggling writing this – but it appears that a recorded Release of Lis Pendens is ineffective and provides no safe harbor to buyers, lenders and tenants and everyone else who trusts that the word “*release*” or “*expunge*” means exactly that.

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