To Our Clients and Friends

Memorandum

New York Appellate Court Reinstates Majority of Title Industry "Kickback" Regulations

On January 15, 2019, in *In re New York State Land Title Association, Inc. v. New York State Department of Financial Services*, No. 151562/18 (N.Y. App. Div. 1st Dep't, Jan. 15, 2019), the Appellate Division of the New York State Supreme Court reversed a trial court decision that had invalidated the New York State Department of Financial Services ("DFS") regulations limiting title insurers' ability to offer inducements to obtain business. The Appellate Court, in reversing, held that the governing statute unambiguously prohibits an insurer from offering or making any payment, rebate, or consideration as inducement or compensation for any title insurance business, and therefore, DFS was entitled to adopt regulations severely restricting the title insurance industry's practice of providing certain entertainment benefits to generate business.

At the center of the litigation is the question of whether entertainment benefits such as dinners and tickets to sporting events constitute standard marketing and entertainment practices, or excessive kickbacks in violation of New York state insurance law.

By way of background, last summer, DFS promulgated Regulation 208, 11 NYCRR 228 ("Reg. 208"), in response to a five-year investigation which found that the title insurance industry spent millions of dollars annually on clientele-building practices, ultimately resulting in higher costs for consumers. DFS argued that these practices constituted a violation of Insurance Law § 6409(d), which prohibits giving any consideration or valuable thing as an inducement for title insurance business. Accordingly, Reg. 208 prohibited a wide range of industry practices that it characterized as inappropriate inducements, specified mandates for expense reporting, restricted standard "tip" payments to closers, and limited ancillary fees, including a 200 percent cap on out-of-pocket costs for searches, among other measures. The title insurance industry petitioned the court, challenging Reg. 208 as arbitrary and capricious and exceeding the DFS's regulatory authority under § 6409(d). In July 2018, the lower court agreed and enjoined enforcement of the statute. Judge Rakower reasoned that § 6409(d) was intended to prevent kickbacks and commission rebates, not to prohibit what she understood as the industry's "ordinary marketing and entertainment expenses." Ultimately, the judge held that DFS's interpretation of § 6409(d) as extending to such expenses was "absurd." DFS immediately appealed.

This week, the Appellate Division vacated the majority of the trial court's order and held that the plain text of § 6409(d) unambiguously prohibits an insurer from offering or making any payment, rebate, or consideration as inducement or compensation for any title insurance business. The court found that Reg. 208's prohibition on certain business practices was consistent with § 6409(d)'s legislative language and intent to prevent consumers from bearing the burden of "unscrupulous exchanges of valuable things for

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real estate professionals." Far from "absurd," the court found that "[Reg. 208] represents a valid exercise of the DFS's general legislative authority and an appropriate elaboration of Insurance Law § 6409(d)."

The court did, however, uphold the trial court's findings that there was no rational basis for the prohibition on certain closer fees and the cap on out-of-pocket costs for ancillary searches.

Considering the court's wide-ranging characterizations of the industry's business practices, from "ordinary marketing and entertainment expenses" to " unscrupulous exchanges of valuable things," it is likely the industry will appeal to the New York Court of Appeals for clarity as to whether § 6409(d) should apply. In the meantime, while title closers (who argued that eliminating tips would deny them the ability to earn a living) are breathing more easily, title insurers are uncertain as to what entertainment expenses will be permitted. In fact, today, Royal Title canceled its sponsorship of "The Main Event," a popular after-party following the annual REBNY banquet.

We will continue to monitor developments in this area and keep you apprised of any updates.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

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