

What the Title Insurance Policy *Really* Covers

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Owner's Policy--ALTA 1992 Form

POLICY OF TITLE INSURANCE

Issued by

BLANK TITLE INSURANCE COMPANY

SUBJECT TO THE EXCLUSIONS FROM COVERAGE, THE EXCEPTIONS FROM COVERAGE CONTAINED IN SCHEDULE B AND THE CONDITIONS AND STIPULATIONS, BLANK TITLE INSURANCE COMPANY, a Blank corporation, herein called the Company, insures, as of Date of Policy shown in Schedule A, against loss or damage, not exceeding the Amount of Insurance stated in Schedule A, sustained or incurred by the insured by reason of:

1. Title to the estate or interest described in Schedule A being vested other than as stated therein;
2. Any defect in or lien or encumbrance on the title;
3. Unmarketability of the title;
4. Lack of a right of access to and from the land.

[additional loan policy insuring provisions shown in italics:]

- [5. The invalidity or unenforceability of the lien of the insured mortgage upon the title;*
- 6. The priority of any lien or encumbrance over the lien of the insured mortgage;*
- 7. Lack of priority of the lien of the insured mortgage over any statutory lien for services, labor or material:*
 - (a) arising from an improvement or work related to the land which is contracted for or commenced prior to Date of Policy; or*
 - (b) arising from an improvement or work related to the land which is contracted for or commenced subsequent to Date of Policy and which is financed in whole or in part by proceeds of the indebtedness secured by the insured mortgage which at Date of Policy the insured has advanced or is obligated to advance;*
- 8. The invalidity or unenforceability of any assignment of the insured mortgage, provided the assignment is shown in Schedule A, or the failure of the assignment shown in Schedule A to vest title to the insured mortgage in the named insured assignee free and clear of all liens.]*

The Company will also pay the costs, attorneys' fees and expenses incurred in defense of the title, as insured, but only to the extent provided in the Conditions and Stipulations.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

BY: _____
PRESIDENT

BY: _____
SECRETARY

EXCLUSIONS FROM COVERAGE

The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorneys' fees or expenses which arise by reason of:

1.
 - (a) Any law, ordinance or governmental regulation (including but not limited to building and zoning laws, ordinances, or regulations) restricting, regulating, prohibiting or relating to (i) the occupancy, use, or enjoyment of the land; (ii) the character, dimensions or location of any improvement now or hereafter erected on the land; (iii) a separation in ownership or a change in the dimensions or area of the land or any parcel of which the land is or was a part; or (iv) environmental protection, or the effect of any violation of these laws, ordinances or governmental regulations, except to the extent that a notice of the enforcement thereof or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.
 - (b) Any governmental police power not excluded by (a) above, except to the extent that a notice of the exercise thereof or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.
2. Rights of eminent domain unless notice of the exercise thereof has been recorded in the public records at Date of Policy, but not excluding from coverage any taking which has occurred prior to Date of Policy which would be binding on the rights of a purchaser for value without knowledge.
3. Defects, liens, encumbrances, adverse claims or other matters:
 - (a) created, suffered, assumed or agreed to by the insured claimant;
 - (b) not known to the Company, not recorded in the public records at Date of Policy, but known to the insured claimant and not disclosed in writing to the Company by the insured claimant prior to the date the insured claimant became an insured under this policy;
 - (c) resulting in no loss or damage to the insured claimant;
 - (d) attaching or created subsequent to Date of Policy; or
 - (e) resulting in loss or damage which would not have been sustained if the insured claimant had paid value for the estate or interest insured by this policy.
4. Any claim, which arises out of the transaction vesting in the Insured the estate or interest insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that is based on:
 - (a) the transaction creating the estate or interest insured by this policy being deemed a fraudulent conveyance or fraudulent transfer; or
 - (b) the transaction creating the estate or interest insured by this policy being deemed a preferential transfer except where the preferential transfer results from the failure:
 - (i) to timely record the instrument of transfer; or
 - (ii) of such recordation to impart notice to a purchaser for value or a judgment or lien creditor.

SCHEDULE A

[File No.]

Policy No.

Amount of Insurance \$

[Premium \$]

a.m.

Date of Policy _____ [at p.m.]

- 1. Name of Insured:

- 2. The estate or interest in the land which is covered by this policy is:

- 3. Title to the estate or interest in the land is vested in:

- [4. The land referred to in this policy is described as follows:]

If Paragraph 4 is omitted, a Schedule C, captioned the same as Paragraph 4, must be used.

SCHEDULE B

[File No.] Policy No.

EXCEPTIONS FROM COVERAGE

This policy does not insure against loss or damage (and the Company will not pay costs, attorneys' fees or expenses) which arise by reason of:

- 1.

- 2. [POLICY MAY INCLUDE REGIONAL EXCEPTIONS IF SO
 DESIRED BY ISSUING COMPANY]

- 3.

CONDITIONS AND STIPULATIONS

1. DEFINITION OF TERMS.

The following terms when used in this policy mean:

(a) "insured": the insured named in Schedule A, and, subject to any rights or defenses the Company would have had against the named insured, those who succeed to the interest of the named insured by operation of law as distinguished from purchase including, but not limited to, heirs, distributees, devisees, survivors, personal representatives, next of kin, or corporate or fiduciary successors.

(b) "insured claimant": an insured claiming loss or damage.

(c) "knowledge" or "known": actual knowledge, not constructive knowledge or notice which may be imputed to an insured by reason of the public records as defined in this policy or any other records which impart constructive notice of matters affecting the land.

(d) "land": the land described or referred to in Schedule [A][C], and improvements affixed thereto which by law constitute real property. The term "land" does not include any property beyond the lines of the area described or referred to in Schedule [A][C], nor any right, title, interest, estate or easement in abutting streets, roads, avenues, alleys, lanes, ways or waterways, but nothing herein shall modify or limit the extent to which a right of access to and from the land is insured by this policy.

(e) "mortgage": mortgage, deed of trust, trust deed, or other security instrument.

(f) "public records": records established under state statutes at Date of Policy for the purpose of imparting constructive notice of matters relating to real property to purchasers for value and without knowledge. With respect to Section 1(a)(iv) of the Exclusions From Coverage, "public records" shall also include environmental protection liens filed in the records of the clerk of the United States district court for the district in which the land is located.

(g) "unmarketability of the title": an alleged or apparent matter affecting the title to the land, not excluded or excepted from coverage, which would entitle a purchaser of the estate or interest described in Schedule A to be released from the obligation to purchase by virtue of a contractual condition requiring the delivery of marketable title.

2. CONTINUATION OF INSURANCE AFTER CONVEYANCE OF TITLE.

The coverage of this policy shall continue in force as of Date of Policy in favor of an insured only so long as the insured retains an estate or interest in the land, or holds an indebtedness secured by a purchase money

mortgage given by a purchaser from the insured, or only so long as the insured shall have liability by reason of covenants of warranty made by the insured in any transfer or conveyance of the estate or interest. This policy shall not continue in force in favor of any purchaser from the insured of either (i) an estate or interest in the land, or (ii) an indebtedness secured by a purchase money mortgage given to the insured.

3. NOTICE OF CLAIM TO BE GIVEN BY INSURED CLAIMANT.

The insured shall notify the Company promptly in writing (i) in case of any litigation as set forth in Section 4(a) below, (ii) in case knowledge shall come to an insured hereunder of any claim of title or interest which is adverse to the title to the estate or interest, as insured, and which might cause loss or damage for which the Company may be liable by virtue of this policy, or (iii) if title to the estate or interest, as insured, is rejected as unmarketable. If prompt notice shall not be given to the Company, then as to the insured all liability of the Company shall terminate with regard to the matter or matters for which prompt notice is required; provided, however, that failure to notify the Company shall in no case prejudice the rights of any insured under this policy unless the Company shall be prejudiced by the failure and then only to the extent of the prejudice.

4. DEFENSE AND PROSECUTION OF ACTIONS; DUTY OF INSURED CLAIMANT TO COOPERATE.

(a) Upon written request by the insured and subject to the options contained in Section 6 of these Conditions and Stipulations, the Company, at its own cost and without unreasonable delay, shall provide for the defense of an insured in litigation in which any third party asserts a claim adverse to the title or interest as insured, but only as to those stated causes of action alleging a defect, lien or encumbrance or other matter insured against by this policy. The Company shall have the right to select counsel of its choice (subject to the right of the insured to object for reasonable cause) to represent the insured as to those stated causes of action and shall not be liable for and will not pay the fees of any other counsel. The Company will not pay any fees, costs or expenses incurred by the insured in the defense of those causes of action which allege matters not insured against by this policy.

(b) The Company shall have the right, at its own cost, to institute and prosecute any action or proceeding or to do any other act which in its opinion may be necessary or desirable to establish the title to the estate or interest, as insured, or to prevent or reduce loss or damage to the insured. The Company may take any appropriate action under the terms of this policy, whether or not it shall be liable hereunder, and shall not thereby concede liability or waive any provision of this policy. If the Company shall exercise its rights under this paragraph, it shall do so diligently.

(c) Whenever the Company shall have brought an action or interposed a defense as required or permitted by the provisions of this policy, the Company may pursue any litigation to final determination by a court of competent jurisdiction and expressly reserves the right, in its sole discretion, to appeal from any adverse judgment or order.

(d) In all cases where this policy permits or requires the Company to prosecute or provide for the defense of any action or proceeding, the insured shall secure to the Company the right to so prosecute or provide defense in the action or proceeding, and all appeals therein, and permit the Company to use, at its option, the name of the insured for this purpose. Whenever requested by the Company, the insured, at the Company's expense, shall give the Company all reasonable aid (i) in any action or proceeding, securing evidence, obtaining witnesses, prosecuting or defending the action or proceeding, or effecting settlement, and (ii) in any other lawful act which in the opinion of the Company may be necessary or desirable to establish the title to the estate or interest as insured. If the Company is prejudiced by the failure of the insured to furnish the required cooperation, the Company's obligations to the insured under the policy shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation, with regard to the matter or matters requiring such cooperation.

5. PROOF OF LOSS OR DAMAGE.

In addition to and after the notices required under Section 3 of these Conditions and Stipulations have been provided the Company, a proof of loss or damage signed and sworn to by the insured claimant shall be furnished to the Company within 90 days after the insured claimant shall ascertain the facts giving rise to the loss or damage. The proof of loss or damage shall describe the defect in, or lien or encumbrance on the title, or other matter insured against by this policy which constitutes the basis of loss or damage and shall state, to the extent possible, the basis of calculating the amount of the loss or damage. If the Company is prejudiced by the failure of the insured claimant to provide the required proof of loss or damage, the Company's obligations to the insured under the policy shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation, with regard to the matter or matters requiring such proof of loss or damage.

In addition, the insured claimant may reasonably be required to submit to examination under oath by any authorized representative of the Company and shall produce for examination, inspection and copying, at such reasonable times and places as may be designated by any authorized representative of the Company, all records, books, ledgers, checks, correspondence and memoranda, whether bearing a date before or after Date of Policy, which reasonably pertain to the loss or damage. Further, if requested by any authorized representative of the Company, the insured claimant shall grant its permission, in writing, for any authorized representative of the Company to examine, inspect and copy all records, books,

ledgers, checks, correspondence and memoranda in the custody or control of a third party, which reasonably pertain to the loss or damage. All information designated as confidential by the insured claimant provided to the Company pursuant to this Section shall not be disclosed to others unless, in the reasonable judgment of the Company, it is necessary in the administration of the claim. Failure of the insured claimant to submit for examination under oath, produce other reasonably requested information or grant permission to secure reasonably necessary information from third parties as required in this paragraph shall terminate any liability of the Company under this policy as to that claim.

6. OPTIONS TO PAY OR OTHERWISE SETTLE CLAIMS; TERMINATION OF LIABILITY.

In case of a claim under this policy, the Company shall have the following additional options:

(a) To Pay or Tender Payment of the Amount of Insurance.

(i) To pay or tender payment of the amount of insurance under this policy together with any costs, attorneys' fees and expenses incurred by the insured claimant, which were authorized by the Company, up to the time of payment or tender of payment and which the Company is obligated to pay.

(ii) Upon the exercise by the Company of this option, all liability and obligations to the insured under this policy, other than to make the payment required, shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation, and the policy shall be surrendered to the Company for cancellation.

(b) To Pay or Otherwise Settle With Parties Other than the Insured or With the Insured Claimant.

(i) to pay or otherwise settle with other parties for or in the name of an insured claimant any claim insured against under this policy, together with any costs, attorneys' fees and expenses incurred by the insured claimant which were authorized by the Company up to the time of payment and which the Company is obligated to pay; or

(ii) to pay or otherwise settle with the insured claimant the loss or damage provided for under this policy, together with any costs, attorneys' fees and expenses incurred by the insured claimant which were authorized by the Company up to the time of payment and which the Company is obligated to pay.

Upon the exercise by the Company of either of the options provided for in paragraphs (b)(i) or (ii), the Company's obligations to the insured under this policy for the claimed loss or damage, other than the payments required to be made, shall terminate, including any liability or obligation to defend, prosecute or continue any litigation.

7. DETERMINATION, EXTENT OF LIABILITY

AND COINSURANCE.

This policy is a contract of indemnity against actual monetary loss or damage sustained or incurred by the insured claimant who has suffered loss or damage by reason of matters insured against by this policy and only to the extent herein described.

(a) The liability of the Company under this policy shall not exceed the least of:

- (i) the Amount of Insurance stated in Schedule A; or,
- (ii) the difference between the value of the insured estate or interest as insured and the value of the insured estate or interest subject to the defect, lien or encumbrance insured against by this policy.

(b) In the event the Amount of Insurance stated in Schedule A at the Date of Policy is less than 80 percent of the value of the insured estate or interest or the full consideration paid for the land, whichever is less, or if subsequent to the Date of Policy an improvement is erected on the land which increases the value of the insured estate or interest by at least 20 percent over the Amount of Insurance stated in Schedule A, then this Policy is subject to the following:

- (i) where no subsequent improvement has been made, as to any partial loss, the Company shall only pay the loss pro rata in the proportion that the amount of insurance at Date of Policy bears to the total value of the insured estate or interest at Date of Policy; or
- (ii) where a subsequent improvement has been made, as to any partial loss, the Company shall only pay the loss pro rata in the proportion that 120 percent of the Amount of Insurance stated in Schedule A bears to the sum of the Amount of Insurance stated in Schedule A and the amount expended for the improvement.

The provisions of this paragraph shall not apply to costs, attorneys' fees and expenses for which the Company is liable under this policy, and shall only apply to that portion of any loss which exceeds, in the aggregate, 10 percent of the Amount of Insurance stated in Schedule A.

(c) The Company will pay only those costs, attorneys' fees and expenses incurred in accordance with Section 4 of these Conditions and Stipulations.

8. APPORTIONMENT.

If the land described in Schedule [A][C] consists of two or more parcels which are not used as a single site, and a loss is established affecting one or more of the parcels but not all, the loss shall be computed and settled on a pro rata basis as if the amount of insurance under this policy was divided pro rata as to the value on Date of Policy of each separate parcel to the whole, exclusive of any improvements made subsequent to Date of Policy,

unless a liability or value has otherwise been agreed upon as to each parcel by the Company and the insured at the time of the issuance of this policy and shown by an express statement or by an endorsement attached to this policy.

9. LIMITATION OF LIABILITY.

(a) If the Company establishes the title, or removes the alleged defect, lien or encumbrance, or cures the lack of a right of access to or from the land, or cures the claim of unmarketability of title, all as insured, in a reasonably diligent manner by any method, including litigation and the completion of any appeals therefrom, it shall have fully performed its obligations with respect to that matter and shall not be liable for any loss or damage caused thereby.

(b) In the event of any litigation, including litigation by the Company or with the Company's consent, the Company shall have no liability for loss or damage until there has been a final determination by a court of competent jurisdiction, and disposition of all appeals therefrom, adverse to the title as insured.

(c) The Company shall not be liable for loss or damage to any insured for liability voluntarily assumed by the insured in settling any claim or suit without the prior written consent of the Company.

10. REDUCTION OF INSURANCE; REDUCTION OR TERMINATION OF LIABILITY.

All payments under this policy, except payments made for costs, attorneys' fees and expenses, shall reduce the amount of the insurance pro tanto.

11. LIABILITY NONCUMULATIVE.

It is expressly understood that the amount of insurance under this policy shall be reduced by any amount the Company may pay under any policy insuring a mortgage to which exception is taken in Schedule B or to which the insured has agreed, assumed, or taken subject, or which is hereafter executed by an insured and which is a charge or lien on the estate or interest described or referred to in Schedule A, and the amount so paid shall be deemed a payment under this policy to the insured owner.

12. PAYMENT OF LOSS.

(a) No payment shall be made without producing this policy for endorsement of the payment unless the policy has been lost or destroyed, in which case proof of loss or destruction shall be furnished to the satisfaction of the Company.

(b) When liability and the extent of loss or damage has been definitely fixed in accordance with these Conditions and Stipulations, the loss or damage shall be payable within 30 days thereafter.

13. SUBROGATION UPON PAYMENT OR SETTLEMENT.

(a) The Company's Right of Subrogation.
Whenever the Company shall have

settled and paid a claim under this policy, all right of subrogation shall vest in the Company unaffected by any act of the insured claimant.

The Company shall be subrogated to and be entitled to all rights and remedies which the insured claimant would have had against any person or property in respect to the claim had this policy not been issued. If requested by the Company, the insured claimant shall transfer to the Company all rights and remedies against any person or property necessary in order to perfect this right of subrogation. The insured claimant shall permit the Company to sue, compromise or settle in the name of the insured claimant and to use the name of the insured claimant in any transaction or litigation involving these rights or remedies.

If a payment on account of a claim does not fully cover the loss of the insured claimant, the Company shall be subrogated to these rights and remedies in the proportion which the Company's payment bears to the whole amount of the loss.

If loss should result from any act of the insured claimant, as stated above, that act shall not void this policy, but the Company, in that event, shall be required to pay only that part of any losses insured against by this policy which shall exceed the amount, if any, lost to the Company by reason of the impairment by the insured claimant of the Company's right of subrogation.

(b) The Company's Rights Against Non-insured Obligors.

The Company's right of subrogation against non-insured obligors shall exist and shall include, without limitation, the rights of the insured to indemnities, guaranties, other policies of insurance or bonds, notwithstanding any terms or conditions contained in those instruments which provide for subrogation rights by reason of this policy.

14. ARBITRATION

Unless prohibited by applicable law, either the Company or the insured may demand arbitration pursuant to the Title Insurance Arbitration Rules of the American Arbitration Association. Arbitrable matters may include, but are not limited to, any controversy or claim between the Company and the insured arising out of or relating to this policy, any service of the Company in connection with its issuance or the breach of a policy provision or other obligation. All arbitrable matters when the Amount of Insurance is \$1,000,000 or less shall be arbitrated at the option of either the Company or the insured. All arbitrable matters when the Amount of Insurance is in excess of \$1,000,000 shall be arbitrated only when agreed to by both the Company and the insured. Arbitration pursuant to this policy and under the Rules in effect on the date the demand for arbitration is made or, at the option of the insured, the Rules in effect at Date of Policy shall be binding upon the parties. The award may include attorneys' fees only if the laws of the state in which the land is located permit a court to award attorneys' fees to a prevailing party. Judgment

upon the award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof.

The law of the situs of the land shall apply to an arbitration under the Title Insurance Arbitration Rules.

A copy of the Rules may be obtained from the Company upon request.

15. LIABILITY LIMITED TO THIS POLICY; POLICY ENTIRE CONTRACT.

(a) This policy together with all endorsements, if any, attached hereto by the Company is the entire policy and contract between the insured and the Company. In interpreting any provision of this policy, this policy shall be construed as a whole.

(b) Any claim of loss or damage, whether or not based on negligence, and which arises out of the status of the title to the estate or interest covered hereby or by any action asserting such claim, shall be restricted to this policy.

(c) No amendment of or endorsement to this policy can be made except by a writing endorsed hereon or attached hereto signed by either the President, a Vice President, the Secretary, an Assistant Secretary, or validating officer or authorized signatory of the Company.

16. SEVERABILITY.

In the event any provision of the policy is held invalid or unenforceable under applicable law, the policy shall be deemed not to include that provision and all other provisions shall remain in full force and effect.

17. NOTICES, WHERE SENT.

All notices required to be given the Company and any statement in writing required to be furnished the Company shall include the number of this policy and shall be addressed to the Company at (fill in).

NOTE: Bracketed [] material optional

1. Who May Make a Policy Claim?

TRANSFER OUT OF LAND TRUST TERMINATES POLICY

Butera v. Attorneys' Title Guar. Fund, Inc., ___ N.E.2d ___, 2001 WL 314663 (not yet released for publication).

The title insurance policy terminated on the deeding of Illinois land trust property to a corporation controlled by the beneficiaries, and a second deed to the beneficiaries. This two-step process was not a distribution within the policy definition of successor insureds. The court gives a very clear statement as to what is a "purchase" as opposed to a transfer "by operation of law."

Joseph, Paul and Giovanni Butera formed a land trust and conveyed property in suburban Chicago into the trust in 1986. Attorneys' Title Guaranty Fund (ATG) issued a policy to the trust company trustee. Giovanni assigned his beneficial interest to Joseph and Paul. Several years later, Joseph and Paul instructed the trustee to convey the property to Joe and Paul, Inc., a corporation they controlled. The corporation deeded to Joseph and Paul two years later, and then dissolved.

The Buteras later learned that there were outstanding taxes from 1978. They submitted a claim to ATG, which denied the claim on the basis that the policy had expired. The Buteras sued for declaratory judgment. The trial court gave summary judgment to ATG, which was affirmed on this appeal.

Purchase or Distribution?

The Buteras' first argument on appeal had to do with the dichotomy between transfers "by operation of law" as opposed to "purchase," as found in the definition of insured in Conditions & Stipulations 1(a):

'insured': the insured named in Schedule A, and, subject to any rights or defenses The Fund may have had against the named insured, those who succeed to the interest of such insured by operation of law as distinguished from purchase including, but not limited to, heirs, distributees, devisees, survivors, personal representatives, next of kin, or corporate or fiduciary successors.

The Buteras argued that each deed was a different kind of "distribution," and therefore fell within that enumerated example of a transfer by operation of law. The Buteras asserted that the deed to the corporation was a distribution from the trust. The court noted that the policy lacked a definition for "distributee." However, it found no basis in law for this claim:

While the Policy uses the term generally, a distribution from a trust does have a specific meaning. Black's Law Dictionary defines a trust distribution as "[t]he cash or other property paid or credited to a trust beneficiary." Black's Law Dictionary 488 (7th ed.1999). Here the first transfer was a distribution not to the beneficiaries of the trust but, rather, to a separate entity, Joe and Paul, Inc. The Buteras do not cite any case or statute to support their claim that the trustee distributed the property to the corporation as a distribution by operation of any law.

The Buteras also claimed that the deed from the corporation to themselves was a distribution by a dissolving corporation, and controlled by *Historic Smithville Development Co. v. Chelsea Title & Guaranty Co.*, 184 N.J.Super. 282, 284, 445 A.2d 1174, 1175 (1981) aff'd in part & rev'd on other grounds, 190 N.J.Super. 567, 464 A.2d 1177 (1983). In *Historic Smithville*, the court found that a deed from a corporation to its sole shareholder, issued on the dissolution of the company, was a distribution of the asset and the grantee became the insured. In response, ATG pointed the court to *Pioneer National Title Insurance Co. v. Child, Inc.*, 401 A.2d 68 (Del.1979), which came to essentially the opposite conclusion on similar facts.

The court found that *Historic Smithville* would apply in this case if Joe and Paul, Inc. had been the named insured. However, the Buteras had not cleared the hurdle of establishing that the corporation was the insured. Therefore, it did not matter whether or not the second deed would terminate the policy.

What is "Purchase"?

The Buteras also argued that their deeds were by operation of law, because

the plain and ordinary meaning of "purchase" denotes a transfer only for valuable consideration and, therefore, "by operation of law" means every method of acquiring property that is not for valuable consideration.

The court found equally reasonable, however, ATG's view that "'purchase' in real estate law covers any acquisition of title by the voluntary act of the parties." The court turned to a basic but trusted reference work to support this position:

Black's Law Dictionary provides two definitions for "purchase": (1) "[t]he act or an instance of buying" (A purchaser is one who obtains property for money or other consideration) and (2) "[t]he acquisition of real property by one's own or another's act (as by will or gift) rather than by descent or inheritance." Black's Law Dictionary 1248 (7th ed.1999). Because "purchase" is able to be defined in at least two different, reasonable ways, we find the term to be ambiguous.

The court was looking for a general principle to guide it, and to reconcile the seeming inconsistency in cases such as *Historic Smithville* and *Child*. ATG supplied the principle, and the court adopted it:

At oral argument, ATG attempted to reconcile these cases with the various terms within the policy language in question. ATG contends successors "by operation of law" under the Policy are those who acquire enforceable property rights without the necessity of conveyance of a deed, as distinct from those who purchase property where paper title changes hands. In each of the examples provided in the Policy, the individuals or entities have relationships to the named insured that preexisted the exchange of title. The "heirs," "devises," "corporate successors," etc., are successors of the named insured because they take the property not from the insured, but through the named insured by operation of

law.

We agree that this interpretation of the policy language gives meaning to all the terms in the provision and fulfills the intent of the parties. It is also consistent with the results reached by the Historic Smithville and Child courts. In Child, the property was deeded by the named insured Child Foundation to the du Ponts, who then deeded it to another entity, Child, Inc. Applying our interpretation, it becomes clear that Child, Inc., was a stranger to the property, having no preexisting relationship to either the Child Foundation or the du Ponts. On the other hand, the property in Historic Smithville was transferred to the shareholders and through the named insured corporation based on their relationship to the corporation.

This interpretation also correlates with public policy. Title insurance is an unusual type of insurance. It is not a recurring policy: there is a single premium, and the policy remains outstanding forever to protect the property owner. Black's Law Dictionary 808 (7th ed.1999). In its definition of "insured," ATG's title insurance policy anticipated changes in the title owner of the insured property, and, thus, changes in the named insured. The Policy, however, placed limits on who could obtain the property and still remain insured under the Policy. Our interpretation of successors "by operation of law" restricts the definition of "insured" to certain foreseeable groups of individuals. Transfers by purchase, on the other hand, would expose the insurer to significantly greater risk because the number of possible transferees is limitless.

Applying this rule to the case at hand, the court ruled:

We find Joe and Paul, Inc., was not a successor to the interest of the Trust by operation of law. The corporation was a stranger to the property with no preexisting relationship to the Trust when the named insured trustee deeded the property to it. While the Buteras received the property as shareholders of a dissolved corporation, the corporation was not a named insured under the Policy and, therefore, the Buteras were not named insureds.

The Buteras also argue that they qualify as "insureds" under the Policy due to the "Continuation of Insurance after Conveyance of Title" section. That paragraph states that "coverage of this policy shall continue in force as of Effective Date of policy in favor of an insured so long as such insured retains an estate or interest in the land." The Buteras argue that, as beneficiaries of a land trust, they are the true "owners" of the property and clearly retained an interest in the land.

Because the Trust relinquished its interest in the real estate when the trustee deeded the property to Joe and Paul, Inc., we need not reach the question whether the Buteras possessed an estate or interest in the property as beneficiaries of the Trust. In this first conveyance, the named insured did not retain an interest in the property. Additionally, as shareholders of the corporation, the Buteras' interest was limited to a share of the profits and the losses of the company and the right to receive a proportionate share of the dividends and assets upon dissolution. In Illinois, the interest of a shareholder in a corporation is deemed to be one in personal property. *Sawko v. Dominion Plaza One Condominium Ass'n No. 1-A*, 218 Ill.App.3d 521, 531, 578 N.E.2d 621, 627-28 (1991). We find coverage under the Policy was not continued to the Buteras after the title was conveyed.

DEED TO LLC TERMINATES POLICY

Gebhardt Family Investment, L.L.C. v. Nations Title Ins. Co., 132 Md.App. 457,752 A.2d 1222 (Md.App. 2000).

Maryland holds that a transfer from the insureds to their family limited liability company for estate planning purposes terminates the coverage of the title insurance policy, even when the insureds are the sole members of the L.L.C.

Joseph and Faye Gebhardt bought land in Maryland and had their title insured by Nations Title Insurance. In 1995, they learned that someone else was paying the taxes on part of the land, and made a claim on their policy. In 1996, before the matter was resolved, the Gebhardts deeded the property to a limited liability company which they had formed as part of their estate plan. They gave the L.L.C. warranties against their own acts only.

In 1997, the Gebhardts sued Nations for failing to resolve the cloud on title. At trial, the sole issue was whether or not the policy terminated on the transfer to the L.L.C. Mr. Gebhardt testified that, although consideration was shown on the deed and a transfer tax paid, "not a penny" changed hands, and he and Mrs. Gebhardt continue to pay the taxes on the property.

The trial court ruled that the deed was not by operation of law, but a voluntary conveyance which terminated the policy coverage. The court rejected the Gebhardts' argument that they remained the effective owners of the property. It also tossed out the notion that the insureds preserved their policy claim by transferring the property after, rather than before, the claim was submitted. The appeals court affirmed on every point.

Voluntary Transfer

This case hinges on the companion provisions regarding termination of the policy and definition of insured. The termination provision is paragraph 2 of the Conditions and Stipulations, which says:

The coverage of this policy shall continue in force as of Date of Policy in favor of an insured so long as such insured retains an estate or interest in the land,... or so long as such insured shall have liability by reason of covenants of warranty made by such insured in any transfer or conveyance of such estate or interest... .

The policy defines "insured" as

the insured named [in the policy] and, subject to any rights or defenses the Company may have had against the named insured, those who succeed to the interest of such insured by operation of law as distinguished from purchase including, but not limited to, heirs, distributees, devisees, survivors, personal representatives, next of kin, or corporate or fiduciary successors.

The Gebhardts conceded at oral argument on appeal that the L.L.C. did not take title by operation of law. Rather, they argued "that because the Gebhardts are the sole members of the

L.L.C. the conveyance was, in effect, to themselves and they still retain an interest in the property within the meaning of Paragraph 2(a) of the policy's Conditions and Stipulations."

The court said that the Gebhardts had "a misunderstanding of the nature of limited liability companies." It quoted from a Virginia case which held that, unlike a partnership, an LLC is "an entity separate from its members and, thus, the transfer of property from a member to the limited liability company is more than a change in the form of ownership; it is a transfer from one entity or person to another." *Hagan v. Adams Property Assocs., Inc.*, 253 Va. 217, 220, 482 S.E.2d 805, 807 (1997). Therefore,

when the Gebhardts conveyed their interest in the property to the L.L.C., they effected a "transfer from one entity or person to another." *Hagan*, 253 Va. at 220, 482 S.E.2d at 807. The Gebhardts and the L.L.C. are separate entities. The Gebhardts may not file suit in their own names on behalf of the L.L.C. Nor may they be held individually liable for wrongful conduct of the L.L.C. While the Gebhardts have an interest in the L.L.C., they no longer have an interest in the property. Rather, it is the L.L.C. that has the interest in the property. To hold otherwise would be to disregard the nature and viability of limited liability companies.

The Gebhardts also posited that there was no transfer because there was no consideration passed at the time of the deed. However, the court noted, the deed "provided the Gebhardts with all of the benefits conferred by a Virginia limited liability company, including limited liability and certain estate planning benefits." This was the consideration for the transfer. The Gebhardts also argued that the payment of a transfer tax was not evidence of a transfer, and the value figure was put on the deed solely to calculate the tax due. The court responded: "[t]he argument is circular, however, in that a transfer tax is a tax imposed on the transferring of property." [citation omitted] If there had been no conveyance, there would have been no tax."

Warranty Liability

The court shut the door on the suggestion that the policy remained alive to indemnify the Gebhardts on their warranty liability. It said:

By conveying the property under special warranty deed, moreover, the Gebhardts covenanted to protect the L.L.C. only against claims made "by, through, or under" the Gebhardts, as grantors. [citation omitted] They did not warrant title against a claim of superior title made by someone else. [citations omitted] There is no suggestion that the alleged cloud on title was created by any action or inaction on the part of the Gebhardts while the property was titled in their names. The Gebhardts thus transferred from themselves to the L.L.C. the problem of the cloud on title as to the 4.75 acres. Should the other persons claiming title to the 4.75 acres bring an action to quiet title, the L.L.C., rather than the Gebhardts, would be required to defend and the Gebhardts could not be held personally liable.

Therefore, the policy did not remain in effect to protect the Gebhardts from warranty liability to the L.L.C.

Claim Made Before Transfer

Finally, the Gebhardts asserted that they had preserved the policy by making a claim before the transfer occurred. They staked their position on the following quote from Palomar, *Title Insurance Law*, s. 4.04[1][a]:

While a transfer of title terminates future coverage, so long as the insured held title at the time of its loss, the insured's subsequent transfer of title does not terminate its pre-existing claim.

Rather than decide head on whether or not professor Palomar is right, the court seized on the insureds' admission that, as yet, they had not suffered a monetary loss. By transferring the property to an uninsured party, the insureds had also transferred the potential loss of title.

Assuming arguendo that there is a "known overlap"--and the record is unclear in that regard--the fatal flaw in this reasoning is that the Gebhardts successfully conveyed the entire property, including the 4.75 acres in question, to the L.L.C. by way of a special warranty deed. As we have explained, the L.L.C. is a separate entity. The problem of the cloud on title is now the problem of the L.L.C. and not the Gebhardts. If any loss is suffered because of the cloud on title, it will be suffered by the L.L.C., which was not an insured under the policy either before or after the conveyance.

The appeals court thus affirmed the trial court judgment in all respects.

DEED TO TRUST TERMINATES POLICY

Covalt, trustee, v. First American Title Ins. Co., 1997 WL 4273 (10th Cir. Wyoming 1997)(unpublished).

Mr. Maytag, the insured, quit claimed to a trust he formed. When the trustee later attempted to sell the property, he discovered a problem with access. The sale price was reduced 30% as a result. The court found that the insurer was entitled to deny the trustee's claim because the definition of insured included only the named insured and "the heirs, devisees, [and] personal representatives of such Insured," and "the Maytag Trust was not an insured under this language." In addition, the court noted that the named insured, Mr. Maytag, had died. Therefore, he "had no insurable interest in the ranch" and was not entitled to make a claim either.

Because Mr. Maytag had conveyed by quit claim, there was no issue in the case about whether or not the policy continued as to "liability by reason of covenants of warranty" made by the insured.

Also of note is *Realty Alliance of Texas, Ltd. v. Stewart Title Guar. Co.*, 1997 WL 13651 (Tex.App.-Hous.) (unpublished), in which a seller asserted that the insurer had paid a claim as a volunteer because, before the claim was made, the insured had conveyed the property to a corporation he controlled, by a limited warranty deed. The insurer accepted the claim "after

much deliberation,” because it considered the case “a close call.” The insurer’s position was stated at trial to be that “these cases are handled on a case-by-case basis and that coverage is not denied automatically if Stewart Title learns of a transfer from its insured to a corporation or other entity close in relationship to the insured.” A significant factor in *Realty Alliance* was that no consideration passed.

DEED TO SISTER CORPORATION TERMINATES POLICY, BUT STOCK SALE DOES NOT

Pioneer Nat’l Title Ins. Co. v. Child, Inc., 401 A.2d 68 (Del. 1979); *Lawyers Title Ins. Corp. v. Cae-Link Corp.*, 45 F.3d 426 (4th Cir. 1995)(unpublished); *Hawkins v. Oakland Title Ins. & Guar. Co.*, 165 Cal.App.2d 116, 331 P.2d 742 (1958).

The policy terminates on the conveyance from one related corporation to another. The *Child* court held that the transfer of title from one affiliated corporation to another terminates the policy, even if the transfer was for no consideration. When the stock and assets of a corporation are transferred voluntarily, the policy terminates. In *Cae-Link*, the insurer issued its policy to Singer Corporation. Singer formed a new corporation, Link Military Simulation Corporation. At that time, Singer conveyed the real estate to Link. The stock of Link was later sold to CAE-Industries of Canada, which then merged Link into a CAE subsidiary. The court found the conveyance to Link to be voluntary, thus terminating the coverage of the policy. The *Cae-Link* case is discussed in Reinhardt and Rader, *Recent Developments in Title Insurance Law*, 31 Tort & Insurance L.J. 513 (1996).

When a corporation is sold by stock transfer, the policy remains in effect. However, *Hawkins* established that the purchaser of the insured corporation’s stock does not directly become an insured.

BUILDER NOT AN INSURED ON LOAN POLICY

Womer v. Melody Woods Homes Corp., 165 Or.App. 554, 997 P.2d 873 (Or.App. 2000).

A builder has no right to rely on a title commitment prepared for the construction lender, because the builder is not the proposed insured, according to an Oregon court.

Melody Woods Homes built a house for David and Terry Womer which encroached on a no-build zone created in a natural gas easement. The easement was shown on a survey and the title commitment prepared by Fidelity National Title for the Womers’ construction lender. The commitment said that the easement was “5 feet along the West line of” another easement. The easement itself says that the pipeline is to be laid in a five-foot-wide easement, and also says the owner may not build within ten feet of the five-foot easement area. The Womer home encroached on the ten-foot strip.

The Womers sued Melody Woods, who sued the surveyor and Fidelity National. The appeals court affirmed a summary judgment in favor of the insurer. The court found that the builder had no right to rely on the commitment:

In this case, the preliminary title report expressly included the disclaimer that it was preliminary only and that it was not to be relied upon. The question is whether, as a matter of law, defendant had the right to rely on it despite the disclaimer. On point in that regard is our decision in *Warrington v. Transamerica Title Insurance Co.*, 40 Or.App. 841, 596 P.2d 627 (1979). In that case, the plaintiff brought an action against a title company for failure to disclose in a preliminary title report the existence of an encumbrance on property that the plaintiff purchased. The report stated that it “shall become null and void unless a policy is issued, and the full premium therefore paid.” The court held that the plaintiff had no right to rely on the preliminary report because its disclaimer “unambiguously informs the reader that, unless he as an insured party obtains a title insurance policy, he may expect no protection from the representations contained in the preliminary report.” *Id.* at 847, 596 P.2d 627. This case is materially indistinguishable. We conclude that the trial court did not err in entering summary judgment in favor of Fidelity.

SELLER NOT A BENEFICIARY OF POLICY

Jimerson v. First American Title Ins. Co., 989 P.2d 258 (Colo.App.Div. 1 1999).

Colorado has held that a seller is not an insured or a beneficiary under the title insurance policy, and may not claim either status as a defense when sued by the buyers on deed warranties in an action paid for by the title insurer. Also, the court said there could be no liability for negligent misrepresentation of title in the title commitment, because the seller had contracted to give good title before the commitment was issued.

Glen Jimerson sold his house. He gave a general warranty deed. First American Title insured his purchaser. A year later, Jimerson’s brother sued the buyer, claiming an interest in the property. First American hired an attorney for the buyer, and that attorney sued Jimerson on his warranties of title.

Jimerson responded by suing First American for negligence and negligent misrepresentation, for not showing the brother’s claimed interest. First American asked for summary judgment. The trial court granted the motion. Jimerson appealed.

Negligent Search

Jimerson’s claim was founded on the idea that First American owed him, as seller, a duty under the title insurance commitment. [The policy was not an issue, and was not even part of the record]. The court found that the insurer had no such duty:

When it issued its commitment for title insurance, the title company offered to issue a title insurance policy to the buyer upon the satisfaction of certain conditions, one of which was the payment of a premium. The terms of the title commitment specifically noted that the title company’s “only obligation” was “to issue” the policy to buyer and that, once the policy was issued, its obligation

under the commitment would be satisfied. Hence, even if it be assumed that seller's payment of the premium, as called for by the commitment, gave rise to some contractual arrangement between seller and the title company, so that seller could enforce the obligations established by the commitment, that obligation was wholly performed when the title company issued the title insurance policy to the buyer in the form called for by the commitment.

Further, the title company did not assume any obligation to seller by virtue of the title insurance policy itself. Although the policy was not made a part of this record, the terms of the commitment make clear that the buyer and a lender were to be the only insureds under the policy and the only persons to whom any obligation was owed.

Contrary to seller's assertion, the mere fact that he paid the policy premium did not make him a party to the policy nor create obligations not expressly provided for in that instrument. See *First American Title Insurance, Co. v. Willard*, 949 S.W.2d 342 (Tex.App.1997) (act of paying title insurance premium does not make payor a party to the insurance contract).

The court also found that Jimerson was not a third party beneficiary of the policy.

That policy was issued for the sole benefit of the buyer and the lender, and none of the documents placed in the record, including those attached to seller's response to the title company's motion for summary judgment, discloses any facts which demonstrate that the title company intended seller to benefit directly from the policy issued to the buyer.

Therefore, the court upheld the summary judgment in favor of First American based on negligence.

SELLER MAY NOT SUE INSURER FOR EMOTIONAL DISTRESS

Stull v. First American Title Ins. Co., 2000 ME 21, 745 A.2d 975 (Me. 2000).

The shareholder of a corporate insured may not sue the title insurer for intentional infliction of emotional distress, Maine has ruled, based solely on evidence that the insurer breached the insurance contract.

Ed Betit owned land on Bog Road in Augusta, Maine. He split the land in two pieces and sold part of it to Albert and Linda Penney, reserving an easement over the Penney land to get to his remaining parcel. Betit ran a trash collection business on the property. In 1992, Betit sold the business to Capitol City. Capitol City is a corporation; Russell Stull is its sole shareholder. Capitol City got a title insurance policy from First American.

Betit did not do a good job dividing the property. When Stull bought, he assumed that a tree line was the true boundary line. In fact, about 20% of the land occupied by the trash company had been included in the deed to the Penneys.

This error was compounded by Keith Varner, First American's attorney-agent, who missed the Penney deed in his title search. Thus, the deed to Capitol City and its policy included the Penney property also. The Penneys and Capitol City got into a dispute about the boundary line. Capitol City notified Varner. He visited the property and then had Betit sign a corrective deed which matched the Penney deed, but did not resolve the boundary-occupation line dispute.

The Penneys sued Capitol City, which tendered to First American. The company denied the claim. It then instructed Varner to issue the policy, adding an exception for claims resulting from lack of title to the Penney land. Capitol City and Stull brought First American into the suit, claiming primarily breach of contract and intentional infliction of emotional distress. The claimed breach of contract was the issuance of the policy with the Penney title exception. Stull's emotional distress claim was based on the insurer's refusal to defend Capitol City. The case went to the Supreme Court in 1998, which decided that the insurer had a duty to defend. *Penney v. Capitol City Transfer, Inc.*, 1998 ME 44, 707 A.2d 387 (1998).

Shortly before trial, Capitol City settled with the Penneys and gave up the disputed land. The trial involved only the claims against First American. Capitol City got a judgment on its breach of contract claim. Stull was awarded \$85,000 for compensatory damages, and \$1.5 million in punitive damages.

Emotional Distress Claim by Non-insured

First American argued that Stull had no standing to sue because he was not an insured, and his claim was merely derivative of the corporate insured's claim. The court disagreed, holding that Stull's claim was in tort, not contract. If he had a valid cause of action, it was "his alone."

The court then dealt with whether or not Stull had an action. Maine follows the rule that an insured may not recover for emotional distress and punitive damages unless the insurer "committed independently tortious conduct beyond the denial of [the] claim." *Colford v. Chubb Life Ins. Co.*, 687 A.2d 609, 616 (Me. 1996). The court rejected Stull's argument that First American's conduct was anything more than breach of contract. The court noted that, on appeal, First American did not contest the finding that it breached the insurance contract. Thus, the court found no tortious conduct by First American. If Stull had been the insured, this would have ended the analysis under *Colford*.

However, the claim by a third party for emotional distress damages was a question of first impression for the court. Stull argued that he should not be bound by the constraints of *Colford*. The court found that such an interpretation would be unjust, however. It reminded Stull that:

[t]hird parties to contracts are strictly limited in their ability to maintain an action under contract law. ... Limiting *Colford* to claims by the insured would essentially eliminate the requirement that a third party prove the parties' intent and would allow the third party to have a more extensive recovery than the insured for what is essentially the same injury. Contract damages are more limited than compensatory damages for a tort and, "[n]o matter how egregious the breach,

punitive damages are unavailable under Maine law for breach of contract”
Drinkwater v. Patten Realty Corp., 563 A.2d 772, 776 (Me.1989).

We appreciate the court’s concern that the presence of an action for breach of contract by the insured should not necessarily bar a third party tort claimant from recovery. Colford, however, does not implicate this concern-- it merely requires that a recovery in tort be based upon conduct, independent of the breach of contract. In the absence of such independent conduct, there is no tort recovery by anyone. Because Stull proved nothing more than a simple breach of contract, his action for intentional infliction of emotional distress fails.

The court thus struck down the judgment in favor of Stull.

BORROWER MAY NOT SUE FOR FRAUD IN ISSUING LOAN POLICY

Miller v. Wilson Title Co., 7/26/00, 2000 WL 1023755 (Tex.App.-Dallas) (unpublished).

When a title agency issued a loan policy only, it made no representation to the borrower, and therefore could not be sued by the borrower for alleged fraud in how the legal description was written.

Mr. Thomas Miller and his wife got a loan from a bank, secured by a deed of trust on their house. The bank got a title insurance policy. The Millers did not. According to Miller, the legal description on the deed of trust was wrong. He sued the title agent that issued the loan policy for fraud. The agent, Wilson Title Company, asked for and got summary judgment. It said that it could not be liable to Miller for fraud, because there was no legal relationship between him and it.

Miller appealed, and the court affirmed.

An essential element of fraud in a real estate transaction is false representation of an existing material fact and a showing that representation is relied on by the plaintiff in entering into the contract. [citations omitted] In its title policy, Wilson made representations only to the bank, not to Miller. There is no evidence that Miller relied on Wilson's title policy in favor of the bank.

Further, Wilson was under no duty to Miller to point out any outstanding encumbrances, and Wilson's only duty was to protect the insured, the bank, against loss as a result of defects in title. See *Wolff v. Commercial Standard Ins. Co.*, 345 S.W.2d 565, 569 (Tex.Civ.App.--Houston, 1961, writ ref'd n.r.e). A mortgagee title insurance policy is an indemnity contract imposing only the duty to indemnify the insured against losses caused by defects in title. *Chicago Title Ins. Co. v. MacDaniel*, 875 S.W.2d 310, 311 (Tex.1994). In this case, the insured was the bank and therefore Wilson had a duty only towards the bank and not towards Miller.

2. Important Distinctions About Policy Coverages

IMPERSONATION NOT COVERED BY LOAN POLICY

Home American Credit, Inc. v. Investors Title Ins. Co., ___ F.Supp.2d ___, 2001 WL 209306 (E.D.N.C.).

When a lender successfully foreclosed on its mortgage, despite the fact that the borrower impersonated a dead person, there was no attack on title or the enforceability of the mortgage, and thus no coverage under the title policy, according to a federal court sitting in North Carolina.

Home American Credit, Inc. made a mortgage loan to a person pretending to be Lorraine Aud, secured by real estate in Emerald Isle, North Carolina. The real Ms. Aud had lived in Iowa, and had died two years earlier. The loan underwriting was "far from standard," the court found. The application did not list any assets, the social security numbers on the pay stubs, W-2s and loan application were not the same, and the loan amount was greater than company guidelines.

The borrower made no payments and never occupied the house. When the lender investigated after default, it found the property in poor condition. The appraised value was \$550,000, but the lender estimated its real value at \$300,000. The loan was for \$400,000.

Home American made a claim on its title insurance policy, apparently premised on the fact that the borrower was the impersonator of a dead person. Eventually, the lender foreclosed. The court ruled that title had passed to Lorraine Aud or her impersonator, and the foreclosure was allowed to proceed. There was no challenge by the borrower or any predecessor in title. Home American then sued Investors Title on its policy claim.

The court firmly grasped the fact that this suit resulted from the fact that Home American found it better economically to seek \$400,000 from the title insurer than to settle for owning a house worth \$300,000.

The plaintiff's contention since more than a year before this suit was filed has been that apparent fraud committed by the lender rendered its mortgage first lien deed of trust invalid so it could not foreclose and protect its security interest in the mortgage loan. However, defendant has never challenged plaintiff's right to foreclose or plaintiff's first mortgage lien priority. The only party that has ever raised the issue concerning the right to foreclose is the lender itself. It is the finding of the court, based on the evidence in the record, that the motivation for the lender to seek title insurance coverage, as opposed to using the traditional means of protecting its interest through foreclosure on the property, was the lender's realization that the property had been overvalued and was worth far less than the amount of the loan or the limits of its title insurance policy. This is why plaintiff waited approximately two years after default to finally initiate foreclosure.

The court granted Investors Title's summary judgment motion. It said:

The essence of the suit and claim for title insurance by Home American is that the transfer of a valid deed to real property to an impersonator does not suffice, that the subject deed was never delivered to the "real" Aud, that title has not vested in Ms. Aud, that Home American's lien on the real property is invalid and unenforceable, and that consequently Home American alleges the deed of trust lien on the property is invalid and unenforceable so that Home American cannot foreclose. However, on inspection of the record and a close review of the title insurance agreement between the parties, the court finds that there is no adverse claim against title by the prior owners of the property and no loss to the lender as a result of any title problem. Title insurance, which "operates to protect the purchaser or mortgagee against defects or encumbrances on title which are in existence at the time the insured takes his title," *Mortgage Corp. v. Insurance Co.*, 299 N.C. 369, 374, 261 S.E.2d 844, 847 (1980), is irrelevant to the issue at hand, and a suit by a lender against the title insurance company is inappropriate.

IMPERSONATION DOES NOT TRIGGER VESTING OF TITLE COVERAGE

Brucha Mortgage Bankers Corp. v. Nations Title Ins. of New York, Inc., 712 N.Y.S.2d 151, 2000 N.Y. Slip Op. 07395 (A.D. 2 Dept. 2000).

A lender that foreclosed its mortgage without challenge and took title to the property had no cause of action against the title insurer based on the claim that the borrower used a false identity in the loan documents, including the insured mortgage.

Brucha Mortgage Bankers Corp. gave a mortgage loan to a borrower who "falsely represented his identity." The court did not explain whether the borrower assumed a fictitious name or impersonated a real person with good credit. The loan went into default, and then the lender discovered that the property had also been appraised for more than value. The lender foreclosed and took title without protest from the borrower.

Brucha then sued Nations Title on the theory that the policy assured the lender against the borrower's use of a false identity. The trial court denied Nations' summary judgment motion, but the appellate court reversed.

The appeals court recited several New York decisions holding that the policy protects a lender only against covered matters, and only "to the extent that its security is impaired and to the extent of the resulting loss which it sustains." The quoted language is from *Diversified Mortgage Investors v. U.S. Life Title Ins. Co.*, 544 F.2d 571, 574, n. 2 (2d Cir. 1976).

Based on these principles, the court ruled:

[I]nasmuch as a valid title was transferred, and [Brucha] received a valid and enforceable first mortgage lien on the property, as evidenced by its ability to successfully foreclose, the defendant satisfied its obligations under the policy (see, *Citibank v. Chicago Title Ins. Co.*, supra, at 222, 632 N.Y.S.2d 779).

The *Brucha* decision is an excellent opinion on the timely subject of fraudulent borrowing. The court makes two important rulings.

First, a mortgage given by an impersonator is not invalid or void. Forgery is the unauthorized execution of a document in the name of the true owner, and is voidable unless a defense exists such as ratification. Impersonation, on the other hand, is the assumption of a different name by a person who is the true owner of the property. No matter what name the true owner uses, the instrument he or she signs is binding and valid. Of course, the adoption of an assumed name or the stealing of someone else's identity is a significant credit risk for a lender. However, it does not affect the title to the property. The title insurance policy does not make any assurance that title is vested in the true legal name of the owner.

Second, the court holds that there is no loss when the lender is able to foreclose the insured mortgage and take title to the property. The policy does not insure that the security for the loan is equal to the loan amount. In impersonation loan fraud cases, the only person who could challenge the validity of the mortgage would be the borrower. However, the borrower rarely if ever makes that challenge. The court found that the successful foreclosure was evidence that the validity of the mortgage had not been disputed. The fact that the lender's security was worth less than it expected did not create coverage.

INSURED DOES NOT MAKE DEFECT BY ATTACKING HIS OWN TITLE

Schwartz v. Stewart Title Guar. Co., 1999 WL 475850 (Ohio App. 8 Dist.) (unpublished).

A title insurer is not required to pay the attorneys' fees in an action the insured brings to assert that his title is bad. Policy duties are not triggered when no one else attacks the insured's title, and the insured is the plaintiff, not the defendant.

Mr. Mark Schwartz bought a unit in Murray Hill Condominiums in Cleveland, Ohio, which is apparently a conversion of existing buildings. The developer did not fix the roof and pool as promised. Mr. Schwartz sued various people, including the developer and architect (Schwartz I). On the same day he filed suit, Mr. Schwartz sent a letter to his title insurer, Stewart Title, telling of his lawsuit and claiming that the condominium declaration was defective. Title was in Murray Hill Company, a corporation, but the declarant was Murray Hill Company, a partnership. Schwartz also claimed that his furnace room encroached into the common elements.

Stewart Title hired counsel to assess the Schwartz claim. Based on the firm's advice, Stewart declined the claim because it had no obligation to prosecute his lawsuit, and no one was attacking his title. However, Stewart hired a second attorney to assist the developer in clearing up the name problem. The attorney drafted an affidavit, which the developer signed and recorded.

The Schwartz suit was tried before a referee for 21 days. He found that the name problem was an error which was at least partly cured by the affidavit. Any remaining doubt could be solved by a quit claim deed. The referee found that Schwartz's title was marketable. He

recommended several ways to cure the encroachment problem. The court adopted the referee's findings.

Schwartz appealed. The appeal was dismissed when the defendants paid Schwartz \$557,000, and agreed to amend the declaration. Schwartz then sold his unit. The new title insurance policy was issued "without reservations or exceptions."

Schwartz then sued Stewart Title for his attorney fees in Schwartz I, of about \$200,000, in addition to bad faith damages. The trial court found that no adverse claim to title was made, so Stewart owed nothing. Schwartz appealed and the court affirmed.

No Defect in Title

The court found that Schwartz had attacked his own title. It looked to the California case of *Manneck v. Lawyers Title Ins. Corp.*, 28 Cal.App.4th 33 Cal.Rptr.2d 771 (1994), in which the title insurer was found not to have a duty to file a declaratory judgment action to determine if the insured's pool and fence encroached onto the neighbor's property. "The same result is warranted in this case because Schwartz's own claims of 'defects' did not invoke coverage."

No Duty to Prosecute

The court also found that Stewart had no duty to prosecute Schwartz I, because the insured brought the suit rather than being sued.

We note at the outset that there is no specific provision of the Policy requiring Stewart Title to pay Schwartz's attorney fees incurred without authority in the suit Schwartz brought against the contractors and developer. ...In sum, the Policy expressly limited the insurer's attorney fee obligation to the payment of fees incurred by counsel selected by the insurer for the defense of a claim made adverse to the title or interest of the insured. The duty to pay legal fees was a product of the duty to defend. ... It is undisputed that Schwartz's fees were incurred to prosecute a case, not to defend one; that Schwartz, not Stewart Title, selected the attorney who prosecuted Schwartz I. We find the plain and unambiguous language of the Policy herein excludes Schwartz's claims... .

No Duty to Cure Title

The court refused to jump the no-duty-to-prosecute hurdle by holding that the insurer had a duty to bring a suit to clear title:

To avoid the Policy exclusion for the attorney fees he incurred in Schwartz I, Schwartz argues that Stewart Title had a duty to cure the title defects that he alleged in Schwartz I. However, no such duty can be found in the Policy. As noted above, the Policy provides a duty to defend an adverse claim; it also provides a duty to indemnify against specified loss or damage in accordance with the Policy terms. There is, however, no duty to cure defects, per se, as might be found in a title guaranty. However, the Policy is one of indemnity not guaranty.

Under the Policy, whether to take action to cure alleged title defects is a matter committed to the sole discretion of the insurer. (See Policy ¶ 4(b)).

Condition and Stipulation 9(a), relied on by Schwartz, explains what happens if Stewart Title exercises this discretionary right, but creates no obligation. That an insurer may take certain action does not mean that it must do so. cf. Manneck, 28 Cal.App.4th at 1301. [other citations omitted]

On this point, the court quoted Barlow Burke:

When an insured title is not the subject of litigation, the insurer has the right to establish the title. The quoted provision above states just this much, but, significantly, no more. The word “right” is used and might be juxtaposed against other words that the drafter of the policy might have chosen. Read in the context of the whole policy, such a provision as this usually appears in conjunction with the “duty to defend” provision, so that, in the policy as a whole, this is a right coupled with a duty.

Burke, *Law of Title Insurance (2nd Ed.)*, § 12.5 at 12:51. The court noted that several cases have suggested that there is a duty to clear title. It rejected that view, saying that [t]o do so would impose a duty where the parties’ agreement provided none.”

The court buttressed its holdings by looking to the “no loss” exclusion. The court found that whatever expense Schwartz incurred he brought on himself, and did not result from the failure of his title:

To trigger the duty to indemnify, the insured must have a claim asserted against the title by a third party because an “indemnity is a * * * collateral promise to make good a loss or injury suffered by a policyholder in consequence of the act of a third party.” Burke, *supra* at § 2.1.1 at 2:4-2:5.

In the case herein, we find no loss was actually sustained by the plaintiff. Although the plaintiff argues his title was made unmarketable because of the defect, this is not a loss suffered by the adverse action or claim asserted by a third party. Without an adverse claim contending the title is unmarketable, the defendant has no duty to provide the plaintiff’s attorney fees and costs.

The wording is important--the policy's coverage here is not of the marketability of title, but of an “unmarketable” one. The negative wording is consistent with the indemnity nature of the policy. To cover marketability of the title insured would be to guarantee the title; to cover its unmarketability is to provide an indemnity against adverse claims asserted against it. A marketable title is one that a vendor, through judicial action, can compel a purchaser to take; an unmarketable title is one that a purchaser, in the course of a transaction, is justified in rejecting at the closing table. Between these two poles, it is possible to find a good title for many purposes, but unmarketable.

A PROPERTY TORT IS NOT A TITLE DEFECT

Sabatino v. First American Title Ins. Co., 308 Ill.App.3d 819, 721 N.E.2d 693, 242 Ill.Dec. 414 (Ill.App. 2 Dist. 1999).

A title insurer is not required to defend an insured in an action by a neighbor seeking an injunction against the insured's "deliberate, wrongful and intentional" disruption of an easement by necessity over the insured's land.

The insureds, Thomas and Joan Sabatino, wanted to build an addition to their home. Their neighbor, Mr. Hershenhorn, told them that his sanitary sewer line ran under the Sabatino property, because the two had originally been one parcel. Hershenhorn objected to a zoning variance and warned them not to proceed. He claimed an easement by necessity. The Sabatinos built anyway. They broke the pipe, rerouted it and hooked their own pump and line to it. This caused sewage to flow onto Hershenhorn's property. He sought an injunction against the Sabatinos' "deliberate, wrongful and intentional" disruption of the easement, but not a declaration of the easement itself.

When Hershenhorn sued, the Sabatinos asked the insurer to defend them. It declined, but agreed to settle the dispute or, in the alternative, pay the insureds the diminution in value resulting from the claimed easement. The Sabatinos sued the insurer for not defending them. The trial court gave them summary judgment. On appeal, the court reversed the decision and gave summary judgment to First American instead.

No Tort Defense Duty

The appeals court held that the lawsuit concerned the insured's interference with the claimed easement, rather than seeking a judicial determination of its existence. Therefore, it did not trigger policy coverage.

First, the underlying complaint does not seek a judicial determination of the existence of an implied easement. Rather, Hershenhorn seeks injunctive relief due to plaintiffs' intentional interference with his easement. Moreover, the purpose of title insurance is to protect a transfer of real estate from the possibilities of loss through defects that may cloud title. See, e.g., *First National Bank of Northbrook, N.A. v. Stewart Title Guaranty Co.*, 279 Ill.App.3d 188, 192, 215 Ill.Dec. 913, 664 N.E.2d 310 (1996). In this case, Hershenhorn's claims are not made against plaintiffs because defendant failed to find an unrecorded easement. Hershenhorn's claims against plaintiffs have arisen because of plaintiffs' allegedly tortious conduct in interfering with Hershenhorn's easement. Such claims are ancillary to the purpose of the title insurance policy. [citation omitted]

* * * * *

In sum, the gravamen of the complaint is not the allegation of an unrecorded easement, but the redress for plaintiffs' intentional and wrongful conduct that occurred after the date of the policy. The complaint in the underlying action presumes the existence of an unrecorded easement by implication and only seeks injunctive relief due to intentional actions that occurred after the policy was issued. Because the policy excludes the type of conduct complained of and provides defendant with the option of establishing a value reflecting the impact of the unrecorded easement on plaintiffs' property, defendant's rejection of

plaintiffs' tender of defense was proper. Accordingly, we find that defendant has no duty to defend... .

This decision is in line with the long line of cases which hold that tortious conduct in obtaining title is not covered by the policy. See *Safeco Title Ins. Co. v. Moskopoulos*, 116 Cal.App. 3d 658, 172 Cal.Rptr. 248 (1981) and *Bidart v. American Title Ins. Co.*, 734 P.2d 732 (Nev. 1987).

TWO CASES ON THE DEFINITION OF "RIGHT OF ACCESS"

United Bank v. Chicago Title Ins. Co., 168 F.3d 37 (1st Cir. Me. 1999); *Riffle v. United General Title Ins. Co.*, 64 Ark.App. 185, 984 S.W.2d 47 (1998).

State law is used to determine the existence or lack of a legal right of access. The land has a right of access if it abuts a public street and ingress and egress from the land to the street is not prohibited. The land also has an appurtenant right of access if it is served by an access easement. A right of access may also be based on prescription or easement by necessity.

Many parcels have a right of access derived from neither an abutting public road nor a permanent easement leading to a public road. Such property is considered to have a right of access if the owner is allowed to travel to the property, and the source of such access right is on par with similar property in that vicinity.

There are many examples. Property lying between a body of water and a railroad right-of-way is typically entered via a revocable license granted by the railroad. The license is normally limited to a certain class of traffic, such as occasional use by the farmer owner (the farm crossing). This license will not support the development of the property as a subdivision, but the property has a right of access nonetheless.

Few reported decisions have dealt with the issue of the sufficiency of access to property in one of the above situations. However, in *United Bank v. Chicago Title Ins. Co.*, a federal court sitting in Maine held that, at least in some cases, a logging road is a sufficient right of access. The property in *United Bank* is a resort which sits at the end of 17 miles of logging roads. The former owner had obtained a license to travel over 11 miles of the roads at a cost of \$100 per year, and the logging company would have given a license over the remaining property if asked. The purchaser at a private auction claimed that he had been promised "deeded access" by the owner and United Bank, which had obtained a title commitment for the sale. "Deeded access" presumably meant an easement. The court found that, no matter what might have been promised the bidder, the policy made no such assurance.

The Chicago Title insurance policy nowhere provides any assurance of deeded access. All that is protected is a "right of access," which could be secured in a variety of ways. No doubt deeded access--e.g., a perpetual easement granted in a deed by the owner of the intervening property--would be more valuable than, say, an easement by necessity under state law or a year to year license for a fee, such as that originally secured by Caliendo but allowed to lapse. Read according to its

terms, the policy does not cover a lawsuit whose gravamen is the promise of something different from and more valuable than a generic right of access.

However, the court was unwilling to uphold the trial court's ruling that access via water was sufficient to satisfy the policy assurance. The resort has two miles of frontage on Lake Spencer, and receives a lot of boat traffic. The appellate court found there to be a question as to whether or not "water access is effective." It quoted an affidavit saying the water access was not "useful." It said that the physical limitations of travel by boat "seems to us to raise a factual question whether water access, even if a 'right,' is meaningful access in this case." The court acknowledged the fact that some property is accessible only by seaplane.

Possibly there are situations in which a right of access in this manner is all that is required. But there is no case law cited to us showing that this is always so for all property, and common sense recoils from such a suggestion.

It concluded that the "adequacy" of the access could not be decided on summary judgment, and so sent the case back to the trial court.

The court also warned United Bank that the damages suffered were slight, if any. The bank's president was personally familiar with the access to the property, and with logging roads generally, and had "never heard of this being a problem." This and other matters in the record suggested that, when the bank made the loan, "it knew what level of land access existed." Access had never been denied. The second auction buyer raised no issue about access. On the other hand, the title agent was also aware of the lack of a public road or easement. Therefore, the court gave this admonition to the parties:

Before United Bank takes more of the district court's time in this matter, we think that United Bank needs to reflect carefully about whether it has a serious claim for reduced value based on the "right of access" clause in the policy where access was apparently available for a nominal payment. Conversely, since Chicago Title's agent also apparently knew the true situation, a split-the-difference payment might be less costly to it than further litigation and the risk of paying all of the difference between some "true" value of the property with a right of access and the later sale price.

An Arkansas case also holds that property is not rendered worthless by lack of overland access, when it is accessible by water. In *Riffle v. United General Title Ins. Co.*, the insureds sued for policy limits when their access easement was found invalid. The court found that the property was not valueless, since the partners could get there by boat, and their intended use was recreational and not commercial. Thus, *Riffle* also supports the rule that rural recreational land does not necessarily require vehicular access over an easement or public road in order to have a right of access appropriate for the property.

POLICY INSURES VALIDITY OF MORTGAGE, NOT DEBT

Pacific American Construction v. Security Union Title Ins. Co., 377 Utah Adv.Rep. 22, 1999 UT 87, 987 P.2d 45 (1999).

The Utah Supreme Court has found that the title insurance policy does not insure the validity of the debt secured by the insured mortgage. When the insured mortgage could not be foreclosed solely because the debt was not enforceable, there was no policy coverage.

Granada, Inc. and its president, Mr. C. Dean Larsen, got a loan from Foothill Thrift. The security for the loan was a trust deed on property owned by Bodenvest, Ltd. Granada was the general partner of Bodenvest. Several years later, Granada filed bankruptcy. Foothill foreclosed on the trust deed. A limited partner of Bodenvest contested, because Bodenvest did not get the loan proceeds and the trust deed “was totally without authorization.” On appeal, Foothill lost and foreclosure was denied. *Luddington v. Bodenvest*, 855 P.2d 204 (Utah 1993).

Pacific American Construction took over Foothill. Following its defeat by Bodenvest, Pacific filed suit on its title insurance policy against Security Union Title and Meridian Title Company, the policy-issuing agent. The trial court held that the loss was covered by the policy. Security Union appealed.

Debt Insurance?

The trial court accepted what the appellate court admitted to be, “at first blush,” a “straightforward and sound” theory: the trust deed was invalidated by the court in *Luddington*; therefore, the policy’s protection against invalidity of the trust deed was invoked. The court said that this misconstrued its prior holding, however.

In *Luddington*, we did not hold that the trust deed was invalid or unenforceable per se; rather, we held that the trust deed was not enforceable against Bodenvest, because “Bodenvest was neither a lender nor a borrower” and received no benefit from the transaction. *Id.* at 208. Thus, the deficiency this court found was not in the trust deed or in the title to the land, but was rather in the failure of the obligation underlying the mortgage lien. Bodenvest received no consideration in exchange for the use of its property as security for the loan to Granada. See *id.* at 210. As has been recognized elsewhere, “failure of consideration is not a covered loss” under the policy language at issue here. *Gerrold v. Penn Title Ins. Co.*, 271 N.J.Super. 50, 637 A.2d 1293, 1295 (N.J.Super.Ct.App.Div.1994) (interpreting the same language).

In support of its position, the court recited from the series of similar cases which have held that the title insurance policy does not insure the validity of the debt underlying the insured mortgage:

Our holding is necessitated by the rule that “a mortgage lien and a mortgage debt are two entirely different ... species.... [A] guarantee of the validity of the mortgage lien cannot and should not be construed as guaranteeing that the insurer has made a careful investigation of the origin of the mortgage debt and guarantees its payment or validity.” *Bank of Miami Beach v. Fidelity & Cas. Co.*, 239 So.2d

97, 99 (Fla.1970). “Generally stated, the provision [at issue here] insures against defects in the mortgage itself, but not against problems arising from or related to the underlying debt.” *Lawyers Title Ins. Corp. v. JDC (America) Corp.*, 52 F.3d 1575, 1583 (11th Cir.1995); see also 60 A.L.R.2d 972, 976 (1958) (stating “a title policy insuring a mortgagee insures only the title to the land securing his debt and not the debt”). In other words, the losses Pacific sustained did not result from a failure of the insured lien; they resulted instead from the failure of the underlying debt claim against Bodenvest. This is demonstrated by the fact that if Bodenvest had received funds from the loan at issue, the trust deed would have been enforceable against it.

Lender In Control of Debt Instrument

The court found it equitable to have the lender bear the risk of the debt being no good, since it is in control of the promissory note or hypothecation, and the loan funding.

The court...found that it was not the normal course of business for the lender to provide promissory notes or hypothecation statements to title companies when requesting title insurance. It would be unreasonable to expect a title company to insure a debt about which it typically would have only limited knowledge and over which the lender would have sole control. A lender--not a title company--is in the best position to insure that the debt underlying a mortgage is valid. Thus, absent specific policy language to the contrary, the lender bears the risk that the mortgage debt is invalid.

In conclusion, we find that the insuring clauses of the Policy do not cover losses arising, as here, from a failure of the debt underlying the mortgage. Accordingly, we reverse the trial court's ruling and order dismissal of the case against Security.

LOAN POLICY VOID WHEN LOAN FUNDS STOLEN BY MORTGAGEE'S CLOSER

Fidelity National Title Insurance Co. of New York v. Consumer Home Mortgage, Inc., 272 A.D.2d 512, 708 N.Y.S.2d 445, 2000 N.Y. Slip.Op. 05066 (N.Y.A.D. 2 Dept. 2000).

When the loan funds were never delivered to the borrowers because they were stolen by the closing agent appointed by the lender, the mortgages were invalid and the title insurer was entitled to a judgment declaring the policies void.

Consumer Home Mortgage, Inc. appointed the law firm of Ferrara & Associates, P.C. and attorney Perry Ferrara to act as its settlement agent on some residential mortgage loans. Ferrara handed the sellers his checks for their net proceeds. The checks bounced.

Fidelity National Title, which had issued title insurance commitments, refused to record the mortgages. The opinion says that title insurance policies were delivered to Consumer, although the mortgages were not recorded. Fidelity filed suit to have the policies declared void. Consumer counterclaimed for payment of loss under the policies.

The trial court voided the policies. The appeals court affirmed. The appeals court noted that the problem was with the loan funding, not the real estate.

Contrary to Consumer's contentions, title insurance insures against loss regarding title to the land, not the underlying debt...[citations omitted] Moreover, where as here, the underlying debt has not been satisfied, the mortgage it was meant to secure must fail (see, *Gerrold v. Penn Tit.Ins.Co.*, 271 N.J.Super. 50, 637 A.2d 1293). Thus, the court properly determined that where there is no underlying debt, there is no valid mortgage, and that the loan policies purportedly insuring said mortgages were not valid or enforceable.

The court also found an exclusion which applies:

Furthermore, coverage was properly denied pursuant to the exclusionary provision in the loan policy in which Fidelity expressly excluded coverage for any loss which Consumer "created, suffered, assumed or agreed to." Here, Consumer admittedly designated Ferrara as its settlement service provider by directing the funds earmarked for the mortgage loans to an escrow account maintained by Ferrara, and by authorizing Ferrara to perform certain duties on Consumer's behalf at the closings. Where a loss is caused by the fraud of a third party, in determining the liability as between two innocent parties, the loss should fall on the one who enabled the fraud to be committed [citation omitted]. Thus, the actions of Ferrara were properly imputed to Consumer. As such, Consumer created the loss which is excluded from coverage.

FORCED REMOVAL ENDORSEMENT COVERAGE

Manneck v. Lawyers Title Ins. Corp., 28 Cal.App.4th 1294, 33 Cal. Rptr.2d 771 (1994); in *Eliopoulos v. Nations Title Ins. of New York*, 1996 U.S. Dist. LEXIS 515 (N.D.N.Y.) (unpublished).

Under some circumstances, the insurer's only obligation when a claim is received is what has been termed "watchful waiting." This is the case when there is a potential for loss, but the coverage in the policy requires the insurer to act only on the occurrence of some further event. For example, in *Manneck*, the policy protected against a final judgment enforcing removal of "structures" located on the property. When the claim was received, no such order had been entered. The insurer was not obligated to clear or defend title. It was found to be entitled to stand by in case an order was entered which would cause a loss under the policy terms. Similarly, in *Eliopoulos*, there were nine alleged encroachments onto the insured property by adjoining owners, which came to the insured's attention. The insured demanded that the insurer clear and defend title. The insurer refused, because no action to assert the alleged encroachments had been taken by any adverse party. The court affirmed summary judgment in the insurer's favor. It held that the encroachments amounted to mere "perceived" encumbrances, and that the insurer had no "affirmative duty to clear title" in such a situation. The court also noted that no action or proceeding had been begun against the insured which required a defense.

"INCORRECTNESS IN THIS ASSURANCE" MAY BE A REPRESENTATION

Alliance Mortgage Co. v. Rothwell, 32 Cal.Rptr.2d 592 (Cal.App. 1 Dist. 1994)

In *Alliance*, the insurer had issued a California Land Title 116 endorsement (commonly known as a “location” endorsement). The court held that the language of the endorsement would allow the insurer to be sued for intentional and negligent misrepresentation. The endorsement issued on three loan policies protected against “any incorrectness in the following assurance:” that the properties each contained a “4-unit Residence.” In fact, two were single-family dwellings and one a duplex. The borrowers had conducted an elaborate fraud on the lender by misrepresenting the nature of the improvements and falsifying all loan documents. The lender realized after default that its collateral was significantly less than the debt. The court found that the endorsement and policy together “amount to a guarantee, not merely a promise to indemnify, as in the conventional title policy.... The specificity of this false description of the property, and the guarantee, together with the alleged reliance thereon, differentiates this case from the routine situation discussed in *Lawrence*.” Id. at 605.

Alliance was reversed on appeal [10 Cal.4th 1226, 900 P.2d 601, 44 Cal.Rptr.2d 352 (1995)], but the misrepresentation holding was not directly modified.

4. Exclusions and exceptions about "public records"

"UNRECORDED EASEMENT" EXCEPTION INCLUDES BUILDING PERMITS

Miller v. Title Insurance Co. of Minn., 1999 MT 230, 987 P.2d 1151 (Mont. 1999).

Montana had found that an exception for easements not in the public records removes coverage as to easements filed anywhere except the recorder’s office.

Scott and Carolyn Miller bought a home in Helena, Montana. They got a title insurance policy from Title Insurance Company of Minnesota (now Old Republic National Title Insurance). The policy contained the commonly-used exception for “easements, or claims of easements, not shown by the public records.”

Eight years later, the Millers began building a garage, and found out that their neighbor’s water and sewer lines ran under the planned garage. No easement was recorded, because the two parcels had been owned by the same person when the lines were installed. However, there were records in the city engineer’s office about the pipes, apparently in the form of a permit application.

The Millers asked Old Republic to pay for relocation of the lines and attorney fees. The insurer declined, because the policy contained the unrecorded easement exception. The Millers said the easement was not excepted because the city engineer’s office records are “public records” under the Montana “public writings” law.

Which “Public Records”?

The Millers said the definition of “public records” in the policy was ambiguous, and therefore should be read broadly. They believed that the title insurer was obligated to inspect “those records which relate to their property and that are open to the public to review and inspect.” The Montana “public writings” law makes open to public inspection all documents “in connection with the transaction of official business and preserved for informational value or as evidence of a transaction and all other records or documents required by law to be filed with or kept by any agency of the state of Montana.” Section 2-6-201(1), MCA. Therefore, the Millers urged, the city engineer’s files were public records which the insurer should have a duty to search and disclose.

The court disagreed. First, it said the policy definition is not ambiguous. It noted that “the title insurance policy at issue in this case specifically defines ‘public records’ as ‘those records which by law impart constructive notice of matters relating to said land.’” Montana’s recording statutes say that only certain records impart constructive notice to a buyer of real estate. The “unrecorded easements” exception removes coverage for easements held by government which do not give notice to a buyer.

In this case, the term “public records” defined in the title policy is not reasonably subject to two different interpretations. The title policy issued to the Millers specifically defines “public records” as “those records which by law impart constructive notice of matters relating to said land.” This is entirely consistent with existing Montana statutory law and Montana recording procedures, which require that documents affecting title to real property be recorded with the county clerk and recorder of the county in which the real property is located.

The applicable Montana statutes, therefore, do not impose a duty upon title insurers to search city engineer or water department records. Pursuant to Montana law and the title policy at issue, a title insurer is only under a contractual duty to investigate the documents properly recorded or docketed and which themselves, or through their contents, impart constructive notice of liens and encumbrances, including easements.

The Millers also argued that they had a reasonable expectation that the title insurer would make a search of the records at the engineer’s office. The court found that, because the policy was clear as to what records it covered, the insured could have no such reasonable expectation. In reaching this conclusion, it noted the insurer’s plea that “no title underwriter could maintain copies of such a broad assortment of records, nor could any local title company research those records every time a request for title insurance was presented.”

LACK OF A SUBDIVISION PERMIT IS A "PUBLIC RECORD"

New England Federal Credit Union v. Stewart Title Guar. Co., ___ Vt. ___, ___ A.2d ___, 2000 WL 217753 (Vt.).

Vermont law prohibits the building of a structure with plumbing and sewage treatment facilities after a land division, unless a subdivision permit is obtained when the parcels are split.

The violation of this law is an encumbrance on title, and covered by the title insurance policy, according to the state supreme court.

The Lafrances divided their property in Essex by selling part of it. They kept less than ten acres, which was vacant land. Vermont law requires that a landowner get a permit on a land division if a structure will be built on it containing plumbing and sewage facilities. The Lafrances got a deferral of the permit because the retained parcel was under ten acres.

Ten years later, the Lafrances sold the retained parcel, which now had a mobile home on it. The land was sold again and the new owner, Mr. Fleming, built a house on it. He got a building permit, but no subdivision permit. Two years later, Fleming refinanced and Stewart Title issued a policy to his lender, New England Federal Credit Union.

Mr. Fleming died. His estate contracted to sell the property. The sale fell through when the buyers learned that no subdivision permit had been obtained. New England Federal then foreclosed and sold the property “at a decreased value of \$10,734.”

New England Federal submitted a claim to Stewart Title, which denied it. The lender filed a declaratory judgment action. The trial court granted Stewart Title’s summary judgment motion, based on the governmental regulation exclusion. That court found that the lack of a permit affected the physical use of the land, not its title. It also ruled that no notice of violation of the law had been recorded in the public land records which would trigger the exception to the exclusion.

New England Federal appealed and the Supreme Court reversed and remanded.

Permit Violation an Encumbrance

The Supreme Court held that the permit violation was an encumbrance. It looked to its own prior decision of *Hunter Broadcasting, Inc. v. City of Burlington*, 164 Vt. 391, 670 A.2d 836 (1995), which found that the state’s health regulations “do affect title to the land” because the owner may not sell the land unless a permit is obtained. In *Hunter*, the court found that the lack of a permit violated the warranty deed’s covenant against encumbrances. In a footnote, however, the court acknowledged that the Vermont legislature changed the subdivision law after oral argument in this case and the *Hunter* argument would no longer apply.

Government Regulations Exclusion

Stewart asserted the governmental regulation exclusion. The court found that it did not apply. First, it ruled that not all government regulations are outside the ambit of the policy, since the exclusion contains a qualifier:

As noted, the policy excludes from coverage any law regulating the occupancy, use, enjoyment or environmental regulation of land, or the effect of any violation of these laws. An exception to the exclusion, however, provides that coverage will not be denied if “a notice of a defect, lien, or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records” at the date of the policy. [Emphasis added] Thus, read in its entirety, the

policy language evinces a clear intent to include violations of land use regulations within the meaning of “encumbrance,” and within the scope of coverage, to the extent that they had been recorded in the public records on the date of the policy.

The court then moved on to deciding if there was a notice of the violation in the public records.

Notice in the Public Records

The exclusion does not apply if “a notice of the enforcement [of the regulation] or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land...recorded in the public records at Date of Policy.” Stewart Title argued that the permit, or lack of same, was not found in the public records, so the qualifier to the exclusion did not apply.

The court again turned to the Hunter decision, and *Bianchi v. Lorenz*, 166 Vt. 555, 701 A.2d 1037 (1997). Those cases held that the records which impart constructive notice include more than just the land records; further, a buyer “using ordinary common sense” can understand when the subdivision regulation has been violated. This “common sense” is apparently derived from reviewing subdivision permit records, which, until 1994, were kept at the state level. In *Bianchi*, the court had imposed the duty on a title searcher to contact the state to see if a subdivision permit had been issued. [The law was changed in 1994 to require the state to put permits in the land records, but the old law applied in this case.] Thus, the court was happy to report that its decision in this case “imposes no additional or unreasonable burdens upon title searchers beyond the normal scope of due diligence.”

The court agreed that the change in the law “provides a clear directive” that, after September 1, 1994, permits or violations are to be placed in the land records. That law would cause the exclusion to apply whenever there was no recorded notice of violation. However, the court reiterated that the new law did not apply in this case, and the records of the Department of Environmental Conservation imparted constructive notice. It found support for its ruling in *Hahn v. Alaska Title Guar. Co.*, 557 P.2d 143 (Alaska 1976) (easement created in Federal Register) and *Radovanov v. Land Title Co. v. America*, 189 Ill.App.3d 433, 136 Ill.Dec. 827, 545 N.E.2d 351 (Ill.App.Ct. 1989) (circuit court records of building code violation lawsuits as public records).

The court justified its broad definition of public records by comparing the wording of the exclusion to an earlier form:

Finally, we note that Stewart Title could have readily achieved the more narrow definition of public records that it seeks here simply by excluding from the definition certain locations where public records containing information about matters relating to land are maintained. In *Somerset Savings Bank v. Chicago Title Insurance Co.*, 420 Mass. 422, 649 N.E.2d 1123, 1126 (Mass.1995), the title insurance policy, like the Stewart Title policy, excluded from coverage any encumbrance resulting from a violation of any law or governmental regulation restricting or regulating the use or enjoyment of land unless notice of the encumbrance was recorded “in those records in which under state statutes, deeds,

mortgages, lis pendens, liens or other title encumbrances must be recorded in order to impart constructive notice to purchasers of the land....” Id. at 426. Unlike the Stewart Title policy, however, the title insurer in Somerset added language explaining that, “without limitation, such records shall not be construed to include records in any of the offices of federal, state or local environmental protection, zoning, building, health or public safety authorities.” Id. Absent any limiting language such as that in the Somerset insurance policy, and prior to the enactment of 18 V.S.A. § 1221b, the policy language here, providing that “records established under state statutes ... for the purpose of imparting constructive notice of matters relating to real property” plainly includes the deferral of permit at the DEC, a public agency which imparts constructive notice of matters relating to real estate.

Somerset apparently construed an ALTA 1984-form policy. The Vermont case involved language used in the 1987, 1990 and 1992 policy forms.

Notice of Violation

Stewart also argued that there was no notice of violation at all. Rather, the “encumbrance” was simply the lack of a permit. The trial court had found that this did not constitute a notice under the governmental regulations exclusion. The Supreme Court disagreed, saying that the policy was ambiguous:

It is unclear whether the policy requires an actual notice of violation or a notice of a defect, lien or encumbrance filed by the Agency of Natural Resources as a result of a violation or alleged violation. Vermont jurisprudence has consistently affirmed the proposition that, when a disputed term is susceptible to two or more reasonable interpretations, the ambiguity must be resolved in favor of the insured. See *City of Burlington v. Associated Electric & Gas Ins. Servs., Ltd.*, 164 Vt. 218, 221, 669 A.2d 1181, 1183 (1995). The policy itself does not define the term “notice.” Its ordinary legal meaning consists of “knowledge of the existence of a fact or state of affairs; the means of knowledge.” *Black’s Law Dictionary* 1061 (6th ed.1990). Stewart Title argues that the article “a” appearing before the word “notice” in the policy required the actual recording of a notice of violation and not several pieces of information which, put together, provided notice. We find, however, a contradiction between that interpretation and the policy’s definition of “public records,” which describes them as records established under state statute for the “purpose of imparting constructive notice” of matters relating to real property. “Constructive notice,” as opposed to “a” notice, is “[s]uch notice as is implied or imputed by law, usually on the basis that the information is a part of a public record or file,” or “[n]otice with which a person is charged by reason of the notorious nature of the thing to be noticed, as contrasted with actual notice of such thing.” Id. at 314. Here, the deeds in the chain of title indicated that Fleming’s parcel was less than ten acres in size and was a portion of a predecessor in title’s larger parcel; this alone should have been an indication to Stewart Title that a subdivision permit was required for the property. See *Hunter Broadcasting*, 164 Vt. at 396-97, 670 A.2d at 840. A search by Stewart Title of the DEC filings

would have revealed the deferral of permit prohibiting the construction of a structure on the property that required plumbing and sewage treatment facilities. This notice was sufficient for purposes of the policy.

In other words, “notice of...a violation or alleged violation” of the regulations was to be implied from the land division itself and the lack of a permit.

The net effect of the court’s rulings was that the exception to the governmental regulation exclusion was applied, and the “encumbrance” of the lack of a permit found to be a defect in title covered by the policy.

Policy Termination

Finally, Stewart Title asked that, if its summary judgment was not upheld, the trial court be instructed to decide if the policy had terminated. New England Federal had sold the property before it submitted its policy claim. The Supreme Court consented, and remanded “for a determination of whether NEFCU had an insurable interest in the land as of the date of its claim.”

4. Tips on drafting exceptions

LESS INFORMATION IS SAFER IN WRITING EXCEPTIONS

Southwest Title Ins. Co. v. Northland Building Corp., 552 S.W.2d 425 (Tex. 1977); *Chrysler First Financial Services Corp. of America v. Chicago Title Ins. Co.*, 595 N.Y.S.2d 302, 306 (Sup. Ct. 1993); *J.H. Trisdale, Inc. v. Shasta County Title Co.*, 146 Cal.App.2d 831, 304 P.2d 832 (1956),.

The insurer has no duty to recite the terms of a recorded instrument, but may be liable for loss incurred by the insured in reliance on faulty information voluntarily supplied. Thus, when the policy provides information about the terms of recorded instruments, that recitation must be accurate or the insurer may face liability for loss incurred in reliance on the inaccurate information.

In the *Northland Building* case, the policy excepted two deeds of trust, each exception stating “securing a note for \$[amount],” the policy was found to have voluntarily assured that the debt underlying the deeds of trust was no greater than the stated amounts. The policy was found to cover an loss caused by additional advances on those deeds of trust. The court reasoned:

When the language of these exceptions is studied, it will be seen that there is no statement to the effect that the coverage of the policy is subject to these certain deeds of trust and to whatever indebtedness may be thereby secured. Instead, the exceptions specify the indebtedness, to wit certain notes, secured by the liens. Since the exception was limited to the prior liens securing that indebtedness, there was no exception for a prior lien securing additional future indebtedness to Citizens State Bank.

Likewise, in *Chrysler First Financial Services*, an insurer inaccurately reported that a senior mortgage was in the amount of \$100,000, when in fact it was for \$180,000. The insurer was found liable for the inaccuracy.

Defendant's argument that it performed its contractual duty by accurately reporting the existence of prior mortgages, liens or charges, without accurately reporting the amount of same, lacks merit. A prospective mortgagee justifiably relies upon the accuracy of the reported search not only as to the existence of prior encumbrances but as to the amounts thereof.

However, no claim was payable until the lender established that it had suffered a loss, and the amount of that loss.

In *J.H. Trisdale, Inc.*, the court treated the title policy like an abstract of title. The insurer identified an easement holder as "Pacific Telephone and Telegraph Company," when in fact the holder was Pacific Gas and Electric Company. The court said it was no defense that the recording data was correct, or that the insured could have investigated further on his own.

[Insured] concedes that if the policy had merely referred to a deed of easement recorded at Book 217 of Official Records, at page 105, without undertaking to name the owner of the easement, there would have been no breach of the policy. However, appellant argues, when respondents went further and voluntarily undertook to name the owner of the easement, they took upon themselves the risk and the obligation of naming the owner accurately. The terms of the policy are clear and unambiguous. They insure plaintiff against any encumbrance not shown or referred to in the policy. A reference to an encumbrance belonging to "A" is not a reference to an encumbrance belonging to "B".

INFORMATION "NOTE" FOUND TO BE A COVERAGE, NOT AN EXCEPTION
BancOhio Nat'l Bank, N.A. v. Security Union Title Ins. Co., 1993 WL 524890 (Ohio App. 10 Dist.) (unpublished).

When the insurer is willing to indemnify against a defect, but not defend the insured in any lawsuit asserting that defect, the assurance is commonly limited to protection against a "final order of a court of competent jurisdiction." However, in one unpublished decision, the court failed to grasp this nuance of coverage. In *BancOhio National Bank*, the policy excepted an existing lawsuit affecting the property, but contained an affirmative "note" assurance using the above phrase. The court held:

While this provision is exclusionary in part, it expressly provides coverage for any loss sustained by way of a final order in *Katz*. Reading all provisions together, it is clear that the policy "insures against" loss arising out of a *Katz* decision. Paragraph 3(A) specifically obligates Security Union to defend in matters "insured against" by the policy. Security Union cannot now avoid its obligation by denying BancOhio a defense in the *Katz* case.

The *BancOhio* decision may also be justified by the fact that the insured was immediately made a party to the excepted lawsuit, which both insurer and insured apparently anticipated at the time the "note" assurance was given. In addition, while the court found the insurer obligated to defend the insured, it was not responsible for reimbursing the insured for its voluntary settlement of the case short of any adverse final order. Thus, to that extent, the court correctly analyzed the spirit of the indemnity obligation undertaken consistent with other similar cases.

FENCE EXCEPTION AND FEE OWNERSHIP

Chicago Title Insurance Co. v. Abstract Associates, Inc., d. 4/4/2000, No. 821 (Ct.Sp.App.Md.) (unpublished).

Maryland holds that an exception for "fences" includes claims of ownership of the land on the other side of the fences, but the trial court must decide if it applies to adverse possession rights only, or recorded deeds also.

Panda Brandywine L.P.C. built an electric power co-generation plant in Prince George's County, Maryland, and got an easement for a waste water pipe leading from the plant to a waste water treatment facility in another county. Panda got coinsurance policies for its real estate from Chicago Title and First American Title, each in the amount of \$65 million.

Each policy contained the following exception: "Fences. (Sheet 41, 39, 3)." The sheet numbers referred to the pages of the survey on which the fences were noted. The fences all affected parcels along the proposed pipeline easement.

The insurers hired Abstract Associates, Inc. to do the title search. That company did not find a deed which made 84 Lumber the record owner of one of the pipeline parcels. The 84 Lumber parcel was outlined by one of the fences referred to in the fence exception. Panda took its easement from the wrong party because of the error. It had to reroute the pipeline to go around 84 Lumber's property, which cost about \$160,000.

Panda made a claim on the policies. The insurers paid, and then sued Abstract Associates to recover their loss. Abstract Associates argued that the insurers had paid the claim as volunteers, because the "fences" exception removed coverage for 84 Lumber's ownership interest. The underwriters responded that the exception was "limited to the fences themselves and, even if applicable to the fenced-in area, it was not intended to exclude anything more than a possible unrecorded adverse possession claim." The insurers were thus in the unusual position of arguing that the exception should be read narrowly rather than broadly.

The trial court granted summary judgment to Abstract Associates, holding that the "fences" exception covered "the fenced-in area as well as all recorded and unrecorded interests in it." The insurers appealed. The appeals court sent the case back for trial on the issue of the scope of the exception.

The appeals court first dealt with the insurers' assertion that the exception was limited to the fence itself, and protected only against the cost to remove it. This argument was supported by

affidavits from insurer employees about the intent of the language, a notation on the survey next to the fence which said "Remove and Replace," and the fact that another exception in the policies referred to the "[r]ights of others in and to the property lying between the fence...and the true property line." The court agreed that this interpretation of the exception "is not unreasonable." However, it also found that "an exception for 'fences' in an insurance policy whose purpose is to insured against title defects, makes little sense if it does not include the area enclosed." The court seemed prepared to affirm the trial court, had that been the only issue.

The insurers' second argument, however, was that the "fences" exception was intended to apply only to claims of adverse possession, not fee title granted by deed.

[W]hen Panda purchased the policies in question, it presumably did so with the reasonable expectation that all adverse recorded claims of ownership would be specifically noted and that the absence of such a notation meant that the exception for "fences" suggested at worst a possible adverse possession claim. Appellants' decision to honor Panda's claim was presumably based on the reasonableness of this assumption.

The court then noted a series of decisions from other jurisdictions, most of which have held that "a non-specific general exception would [not] exclude an undiscovered recorded ownership interest." The court sent the case back with the instruction that the trial court consider the following factors in interpreting the exception:

the intentions of the parties, the reasonable expectations of a title insurance purchaser, the insured's knowledge of an adverse claim, and the duty, if any, of the insured to inspect the property.

5. How a Typing Error Can Give a Coverage

POLICY REFORMED TO REMOVE LAND INSURED BY MUTUAL MISTAKE

Lawyers Title Ins. Corp. v. Golf Links Development Corp., 87 F.Supp.2d 505 (W.D.N.C. 1999).

In North Carolina, a title insurance policy was reformed to remove land not owned by the seller when the source of the error was the purchase agreement, which the insured reviewed but failed to correct.

The Tomlinsons bought Lot 28 of a subdivision in Macon County, North Carolina, from Holly Springs Golf and Country Club. They built their home on it.

The golf club fell on hard times and filed bankruptcy. The trustee sold the course to the pension fund of a New Jersey local of the Teamsters union. Eight years later, Golf Links Development Corporation offered to buy the course from the Teamsters for \$100,000 cash and a note back for \$750,000. The Teamsters attached a legal description to the offer which accidentally included Lot 28, the Tomlinson home. Golf Links had a due diligence period for

verifying the legal description, which passed without objection. Lot 28 was included in the deed to Golf Links.

The president of Golf Links, Gary Doyens, was apparently the only person in that group to understand what property was being purchased. He testified that the Tomlinson house was not inventoried, appraised, inspected by him, or made part of their business plan. However, before the closing, Doyens brought in Mr. Thomas Trexler to finance the purchase by making a public stock offering. Trexler substantially rewrote the offer to purchase, but did nothing regarding the legal description. He personally inspected the property only briefly.

Trexler became the majority shareholder in Golf Links. After the purchase, Doyens left in a dispute about the property's management.

After Doyens left, an investor in Golf Links investigated what seemed to be an inflated tax assessment for the property. He discovered that the tax roll showed two Lots 28, and thus the value of the Tomlinson home was included in the assessed value of the golf course. Trexler called the course manager, Mr. Jon Rogers, and told him they owned the home. When Rogers protested, Trexler said:

Yes, we own it. And we're going to sue, and we're going to get triple damages. We're going to get \$750,000 and pay off the union, so it won't cost me any money... . This is free money. We can pay off the golf course, get rid of the union, and do what we want. This is like a blessing in disguise... . People make mistakes, and they pay for them.

Golf Links then made a claim on its title insurance policy, issued by Lawyers Title Insurance. The company contacted the attorney who had prepared the title opinion on which the policy was based, who had also represented Golf Links at closing. He advised by letter that the legal description was a mistake, which Golf Links appeared to want to exploit. Based on this letter and its own investigation, Lawyers Title denied the claim. This suit followed. Lawyers Title sought summary judgment on its argument that the policy should be reformed based on mutual mistake.

When is Mistake Mutual?

In asking to have the policy reformed to remove Lot 28, Lawyers Title was required to prove that both it and Golf Links had made a mistake. Golf Links asserted the title attorney's admission that he "wasn't careful enough" in reviewing the legal description as a bar to reformation. The court quoted from *Metropolitan Property & Cas. Ins. Co. v. Dillard*, 126 N.C.App. 795, 798, 487 S.E.2d 157, 159 (1997):

Reformation is a well-established equitable remedy used to reframe written instruments where, through mutual mistake ... the written instrument fails to embody the parties' actual, original agreement. A mutual mistake is one shared by both parties to the agreement

[N]egligence on the part of one party [which induces the mistake] does not preclude a finding of mutual mistake. In other words, the fact that the mistake

arises because the party who is seeking reformation supplied the incorrect information does not make the mistake unilateral.

Applying *Metropolitan*, the court found that “the fact that the attorney for the seller mistakenly attached Exhibit A containing a description of Lot 28 is of no moment. [Golf Links’] attorney readily admitted he mistakenly allowed the description to remain in the contract and the deed.” Mr. Trexler’s “naked opinion” that Golf Links owned everything on Exhibit A “requires inferences which do not fall with[in] the range of reasonable probability,” and therefore were not entitled to be considered by a jury. The court thus granted Lawyers Title’s motion for summary judgment reforming the policy.

POLICY TYPIST CAN GIVE ACCIDENTAL COVERAGE

Hilliard Properties, Inc. v. Commonwealth Land Title Ins. Co., 1997 WL 781727 (Ohio App. 8 Dist.) (unpublished), app. not allowed, 81 Ohio St.3d 1503, 691 N.E.2d 1062 (table); *Inavest Enterprises v. TRW Title Ins. of New York, Inc.*, 189 A.D. 2d 111, 595 N.Y.S. 2d 837 (3d Dept. 1993); *Arizona Title Ins. & Trust Co. v. Smith*, 21 Ariz.App. 371, 519 P.2d 860 (1974).

In *Hilliard Properties*, the insurer excepted a special assessment in the commitment but the policy typist inadvertently failed to carry the exception into the policy. The court said the policy protected against the assessment, using this circular argument:

Although Commonwealth argues that Hilliard, through its purchase agreements buying and selling the property, assumed the obligation to pay the assessment, the policy stated that no special assessments were attached to the property. In construing contracts, specific provisions are generally read to negate conflicting general provisions. [citation] Here, the policy specifically provided coverage against the special assessments, where the exclusion terms were of a general nature. Accordingly, the assessment was insured against.

In *Inavest*, the commitment missed back taxes, but the contract made the buyer responsible for all taxes. The court held that the insurer was responsible for the taxes because there was no specific showing that the purchase price was adjusted for taxes in a known amount. The insured partnership obligated itself in the purchase agreement to “pay all arrears in taxes,” the court duly noted that several of the partners were real estate brokers and the partnership got a distressed-sale price in part because the insured knew that there **were** delinquent taxes. However, the court insisted that the insurer prove that the partnership had actual knowledge of the exact taxes which were omitted. Similarly, in *Arizona Title Ins. & Trust*, boilerplate language of an exchange agreement which stated that the purchaser would take “subject to” all “assessments” did not establish that the insured had the requisite knowledge to have “agreed to” a \$14,000 special assessment which was omitted from the preliminary report.

The company relies heavily upon the fact that the exchange contract mentioned the word “assessments” three times--once in typewriting and twice in the printed form. We cannot say as a matter of law that the insured had knowledge of the assessment merely because

he signed this agreement when the document contained neither the total amount due on the assessment nor the yearly payment on it, but only the word "assessments."

The insurer also attempted to show conscious assumption of the assessment by testimony of the seller that he had told the insured, that a listing sheet referred to the assessment, and that the purchaser's broker had actual knowledge which should be imputed to the insured. The court accepted evidence of this type as valid in principle, but found there was no such evidence in this case.

6. What the Insured Knows Can Hurt It

KNOWLEDGE OF AN OFFICER IS KNOWLEDGE OF THE CORPORATION: WHY THE NON-IMPUTATION ENDORSEMENT IS SO VALUABLE

Carefree Living of America (Minnetonka), Inc. v. Chicago Title Ins. Co., 2000 WL 290411 (Minn.App.) (unpublished).

A Minnesota court has ruled that an insured corporation is bound by the knowledge of its officer who made title defective. Therefore, because the officer failed to disclose the defect to the insurer, the matter was removed from coverage under exclusions 3(a) and 3(b).

Mr. Wilnard Selbak "acquired title to the property insured through a series of questionable transactions among corporations and limited partnerships created and controlled by him, including a transfer of title to him by a quitclaim deed that was never filed as a public record." These transfers caused title defects not further described by the court.

In 1995, Selbak and a minority shareholder incorporated Carefree Living of America (Minnetonka), Inc., with Selbak as president. Selbak then deeded the property to Carefree. Carefree mortgaged the property, with Selbak alone executing that mortgage. Selbak attended closing. He "knew of the dubious history of the title transfers and in that sense could be said to have created or assumed the defect. Selbak also knew about the unrecorded quitclaim deed and failed to disclose its existence at closing."

Selbak apparently left Carefree. When the title defects he had created came to light, Chicago Title denied the claim. This lawsuit followed. The trial court granted summary judgment to the insurer, and the insured appealed.

Imputed Knowledge

Both Carefree and the court rolled the two exclusions together, with somewhat confusing result. The court noted that Minnesota has no prior case law on either exclusion. It looked to *American Savings & Loan Ass'n v. Lawyers Title Ins. Corp.*, 793 F.2d 780 (6th Cir. 1986) for a judicial gloss on "created," "suffered" and "assumed," noting the element of intent which the *American Savings* court attached to each. The court emphasized Selbak's deliberate acts which created the defect in title. However, the court also found important Selbak's failure to disclose his knowledge of the unrecorded deed, even as he sat at the closing table with the title insurer's representative.

Carefree further blurred the two exclusions by linking knowledge, under Exclusion 3(b), to the requirement of intent under 3(a). It argued that "the corporation did not have actual knowledge of the alleged title defect, but only knowledge imputed to it by Selbak's actions, and thus cannot be said to have acted in a deliberate manner."

The court did not disentangle the exclusions. It did, however, firmly rule that Exclusion 3(b) includes imputed knowledge. Carefree had argued that the definition of knowledge in the policy did not specifically include knowledge imputed to a corporation from one of its officers. It said that "actual knowledge" in the policy definitions should not include knowledge imputed from public records. In response, the court noted several decisions which had held that an officer's knowledge is imputed to the corporation. Then it stated:

The definition excluding implied knowledge must be read as a whole; only that knowledge imputed by reason of a public or other record is excluded. The knowledge here, while imputed to Carefree because of Selbak's status as an officer, is not based on public or other record, but rather on Selbak's actual knowledge.

When opposing the grant of summary judgment, a party must show something more than "some metaphysical doubt as to the material facts." [citation omitted] Carefree's claim that corporate knowledge can somehow be isolated from the actual knowledge of a corporate officer or director is such a metaphysical doubt.

PROPOSED INSURED HAS DUTY TO DISCLOSE KNOWLEDGE OF TITLE DEFECT
Kirwan v. Chicago Title Insurance Co., 9 Neb.App. 372, 612 N.W.2d 515 (Neb.App. 2000).

Nebraska has delivered a strong decision voiding policy coverage when the buyer fails to disclose pre-policy notice that title is being attacked. The insured must repay the insurer for its cost in defending both owned and lender.

David, Harry and Betty Vanderwerf bought property in South Dakota as tenants in common with four members of the James Kirwan family. Harry and Betty chose not to come into title. After four years, the property, known as the Kirwan Ranch, was not doing well. The Kirwans told David that they would buy him out with a loan from a local bank, but he had to give them a quit claim deed as collateral. They promised that the deed would not be recorded.

David's deed was recorded the same day in September, 1995 on which he signed it. In December, the James Kirwans signed a deed conveying the property to James' cousin Gerald and his wife Leona. Gerald and Leona got a mortgage loan from First Trust N.A. The closing may have been in several stages. The court said that it took place on the 9th, but also recited that it occurred the week of April 1st. The deed was recorded on April 15, 1996.

Chicago Title insured the Gerald Kirwans' title. Its commitment effective date was April 1st. The policy date was May 16th.

The Vanderwerfs learned of the sale to the Gerald Kirwans in November, 1995, before the deed was signed. Their lawyer wrote to the Gerald Kirwans on April 5, 1996, making a claim to the property. The Kirwans received the letter on the 7th or 8th. The court determined that the letter was the Gerald Kirwans' first notice of the Vanderwerfs' claim to the property. The Kirwans did not tell Chicago Title about the Vanderwerf letter.

The Vanderwerfs filed suit to set aside the deed and mortgage on May 16th, the policy date. The Kirwans tendered the lawsuit to Chicago Title, which accepted the defense under a reservation of rights. It later withdrew from their representation. The company defended the lender, First Trust. The Kirwans and their lender were found to be bona fide purchasers and encumbrancer without notice, in a case that went to the state supreme court. 1998 SD 119, 586 N.W.2d 858 (1998).

The Kirwans sued Chicago Title for their defense costs. The insurer asserted that the lawsuit was not covered because the Kirwans failed to tell the company of the adverse claim of title as required by the commitment, and policy exclusion 3(b) thus applied. The district court gave summary judgment to Chicago Title, and ordered the Kirwans to reimburse the company for its cost in defending them. However, the court denied the insurer's request for reimbursement from the Kirwans for the cost of defending their lender.

Both sides appealed. The appellate court upheld the summary judgment in favor of the insurer. It also ordered the Kirwans to pay Chicago Title back for the defense of their lender.

Duty to Disclose Adverse Claim

The court agreed with the insurer that, if the insured fails to disclose an adverse claim as required by the commitment, the matter is excluded under 3(b). The Kirwan commitment was an ALTA 1966 form. Paragraph 2 of the Conditions and Stipulations to that form says:

If the proposed Insured has or acquires actual knowledge of any defect, lien, encumbrance, adverse claim or other matter affecting the estate or interest or mortgage thereon covered by this Commitment ... and shall fail to disclose such knowledge to the Company in writing, the Company shall be relieved from liability for any loss or damage resulting from any act of reliance hereon to the extent the Company is prejudiced by failure to so disclose such knowledge.

Exclusion 3(b) removes coverage for:

Defects, liens, encumbrances, adverse claims or other matters ...not known to the Company, nor recorded in the public records at Date of Policy, but known to the insured claimant and not disclosed in writing to the Company by the insured claimant prior to the date the insured claimant became an insured under this policy....

The court found that the commitment and policy provisions dovetail, and are a reasonable limitation on coverage:

The language of the title commitment is clearly intended to force the insureds to tell Chicago Title what they know or come to know about the property and its title, which is not of record, so that the risk which Chicago Title assumes in the policy can be assessed and guarded against. The quoted provision of the policy clearly excludes from coverage those claims which the insureds had knowledge about, but failed to disclose in writing to the insurer. Such limitation on liability is consistent with *Farm Bureau Ins. Co. v. Witte*, 256 Neb. 919, 594 N.W.2d 574 (1999).

The Kirwans argued that the provisions are a trap for legally innocent insureds such as themselves. Their argument, according to the court, was that the exclusion

leaves a bona fide purchaser who relies on a title commitment at risk, and without coverage, for the interval between a commitment and the policy date.... [I]f the insured learns of a claim within this interval, the insurer has no duty to defend.... It creates a "catch" for innocent insureds who learn of an adverse claim after closing while awaiting their policy, and leaves them uninsured though their premium is paid.

The court found that the duty to disclose a known title defect is not too great a burden, and is essential to the insurer's undertaking of risk:

The fact is that the policy commitment is written to force the insured to disclose known potential adverse claims not of record so that Chicago Title can amend Schedule B (the matters not insured against) to include an adverse claim which arises after the commitment is issued, but before the policy is issued. The ability to amend the schedule is expressly provided for in paragraph 2 of the conditions and stipulations of the commitment, and thus there was no representation that late-disclosed adverse claims could not be excluded by the policy issued after the commitment. The Kirwans' position that Chicago Title cannot exclude coverage for the Vanderwerf litigation, given that it was not of record or disclosed, is tantamount to a driver buying automobile insurance on Monday and complaining because the insurance company will not cover the accident occurring 2 days before on Saturday. The clear language of the commitment allows Chicago Title to exclude or limit coverage on Schedule B when the policy is issued for an adverse claim which comes to light after the commitment but before the policy is issued. However, nondisclosure results in a new and undisclosed adverse claim being excluded from coverage. By the time the Kirwans disclosed the Vanderwerfs' claim, the commitment had "evaporated" by its express terms and the policy controlled, meaning that Chicago Title did not need to show that it had suffered prejudice from the nondisclosure.

The district court, in its well-reasoned order, said regarding prepolicy issuance acquisition of knowledge of adverse claims by the proposed insureds: "The rationale of title insurance is a coverage of risks ascertainable to both parties from the public records and not otherwise ascertainable by the proposed insured

and the insurer. Permitting an insured to obtain coverage for something he or she knew about, but which was unknown and unknowable to the insurer, upsets the actuarial basis and justification for title insurance. Common sense supports the application of an exclusion to such situations[.]"

Letter Not "Serious" Enough to Require Disclosure

The Kirwans also argued that the letter from the Vanderwerfs' attorney was not concrete enough to require the Kirwans to disclose it to the insurer. They characterized it as:

a vague, threatening letter from a South Dakota lawyer claiming his client had an interest in the land. The letter ambiguously claimed either a right to sale proceeds for the land, or an interest in title. Neither the buyers nor their attorney took the threat seriously; in any event, the transaction had already closed.

The court found that, no matter how the letter is characterized, the interest claimed in the letter was excluded because the insured did not tell the insurer about it.

The letter to the Kirwans was from an attorney and clearly asserted that the Vanderwerfs had either a right to the sale proceeds or an interest in title to the land. That is all the Kirwans needed to know in order to alert Chicago Title to this "adverse claim." Whether they believed it to be meritorious and serious is completely beside the point. Once the Kirwans got notice, they were duty bound to give notice to Chicago Title, and since they failed to do so, the policy, which was issued and superseded the binder, excluded the Vanderwerfs' claim from coverage.

Thus, the court accurately focused not on the gravity of the action taken to assert the adverse interest, but on the nature of the claim made. Since the lawsuit was based on exactly the same claim made in the letter, by the same party, the lawsuit was excluded because the Kirwans did not tell Chicago Title about it.

Lack of Prejudice

The Kirwans then circled back to the commitment statement that the insurer "shall be relieved from liability" for undisclosed matters "to the extent the Company is prejudiced by failure to so disclose such knowledge." They argued that the company was not prejudiced, because the insureds won the lawsuit.

The court said the Kirwans were ignoring the reality of what an insurer does with information of an adverse claim after it is properly disclosed:

This argument at the outset ignores the difference between the commitment and the policy. Nonetheless, their argument is that as long as the purpose of the notification clause was fulfilled, then the insurer should not be relieved from its obligations to defend under the policy. The purpose of most notification clauses in insurance policies is to put the insurer on notice of a potential claim and to afford the insurer an opportunity to promptly investigate the merits of the claim. However, a notification

requirement in a binder is different because it is, in effect, an underwriting device which forces disclosure of adverse claims not of record which present a potential risk to the title. The disclosure enables the insurer to assess the risk, describe it as it wants in Schedule B "Exceptions from Coverage," and charge a premium which is reflective of the risk being carried. The insured can then determine whether the coverage set forth in the policy, with exceptions, is worth the proposed premium. The fact that the adverse claim later proves nonmeritorious does not dispense with the insurer's understandable desire to know what the insured knows and which is not of record. In this way, the insurer can assess the risk posed by the adverse claim uncovered after the commitment, but before the policy is issued. We have little doubt that if this was a health care policy with exclusions for known preexisting conditions, a claim that a known but undisclosed condition such as leukemia should be covered because its treatment later proved successful, would likely not succeed in the patient's suit for the cost of treatment. The Kirwans' argument is similarly unpersuasive. The Kirwans' argument suffers from a failure to appreciate Chicago Title's contractual ability to rewrite the "Exceptions from Coverage" during the pendency of the commitment, as well as a failure to recognize that paying to defend a claim of which it was uninformed is inherently prejudicial to Chicago Title.

... . While we conclude that paying to defend an undisclosed claim would be prejudicial to Chicago Title, a showing of prejudice was unnecessary.