

TITLE ISSUES

The 1990 ALTA Policies — A Case for Change

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Chicago Title, along with most of the title insurance industry, has recently converted the form of policies it issues to the 1990 American Land Title Association (ALTA) forms. Previously, the most widely used forms had been the 1970 ALTA forms with limited use of the 1984 and 1987 versions.

ALTA is the trade association of the title insurance industry. The standardization of forms is a function of the Forms Committee of the Underwriters Section.

Having established a standardized form, changes in it are not taken lightly. Major customer groups, such as lender and life insurance counsel, are consulted and their input is solicited. Essentially, the changes made are responsive to changes in law (legislative or adjudicated) and in the business environment. Revisions have therefore been intended to either expand or contract coverage, or to clarify coverage, by definition or by restructuring its form.

Perhaps the most distinguishing feature of the recent changes in the ALTA forms is not so much the form of the changes as the withdrawal of the ALTA designation from all but the 1990 forms for the types of policies most in use. In the past, the practice had been simply to approve additional forms or versions of forms. This change in stance appears to reflect the serious nature of the problems facing the title insurance industry as a whole.

I. Why Change?

As indicated above, changes in policy forms have been responsive to a problem or need. Prior to and culminating with the 1970 forms, that response may generally be described as an effort to expand coverage to satisfy the needs of participants in modern real estate transactions.

The title insurance policy is an indemnity contract. Its principal thrust is the prevention of risk rather than the assumption of it, although there are certainly a limited number of risks which are in fact assumed. However, courts have tended to lump cases involving title policies with those casualty in nature, often with disastrous effects to the industry. We have seen instances of judicial legislation on one hand and of judicial interpretation on the other which have shaken the traditional stability associated with the ownership of real estate.

There have also been legislated changes, both on state and federal levels which have had an impact on policy liability. Most recent of these are amendments to the Bankruptcy Code and state fraudulent conveyance laws.

There have been numerous changes in our economy which

have had a dramatic impact on the title industry. Leveraged buyouts (such as the buyer of a corporation borrowing against its assets to raise the purchase money), the dramatic increase in acceptability and use of bankruptcy resulting in the setting aside of transactions (such as sales, mortgages, foreclosure sales, etc.), the whirlpool effect of being drawn into malpractice actions of various types and the threat of environmental cleanup exposure are just some of the causes of problems with a negative impact.

As a result, the title industry has experienced a dramatic escalation of claims payments. As reported by ALTA, the industry suffered over \$350 million in claims in 1990. For the second consecutive year, only two companies operated in the black. One of them was the Chicago Title family of title insurers. For Chicago Title Insurance Company, the claims payout will range between \$60-70 million. In 1985, Chicago Title paid \$26 million and in 1980, \$10 million.

Hence, it was perceived that an urgent need existed to clarify what title coverage is and what it is not. The result was the 1987 ALTA amendments. The 1990 change was to add an Exclusion From Coverage for creditors rights issues. In discussing the changes, we will focus on the 1990 policies, incorporating the 1987 changes, and compare them with the 1970 forms.

II. Forms of Policies Changed

As of October 1, 1991, ALTA withdrew recognition of all but the 1990 forms. As a result, for applications made after that date, Chicago Title will issue the following policy forms:

- ALTA Owner's Policy (4-6-90)
- ALTA Loan Policy (4-6-90)
- ALTA Leasehold Owner's Policy (4-6-90)
- ALTA Leasehold Loan Policy (4-6-90)
- ALTA Construction Loan Policy (4-6-90)
- ALTA Short Form Residential Loan Policy (4-6-90)
- ALTA Residential Owner's Policy (6-1-87)

The last-noted Residential Policy, being the so-called "plain English" policy was not amended in 1990 as the risk of creditors rights problems was not thought to be a concern for single family residential property.

III. What is Changed?

A. Insuring Provisions.

1. Owner's Policy.

- a. There is no longer a designation of Form A (no coverage for unmarketability) or Form B (with unmarketability coverage). The 1990 policy includes unmarketability coverage.

- b. The reference to costs of defense has been removed from the initial insuring paragraph to a separate paragraph on the cover. There is no intention to reduce coverage, only clarify it.
 - c. The order of insuring paragraphs 3 and 4 has been reversed.
2. Loan Policy.
- a. The amendments noted at A.1.b and c above for the Owner's Policy also apply to the Loan Policy.
 - b. Paragraph 5 has been amended to delete the exceptions for usury, etc., those exceptions being transferred to the Exclusions from Coverage paragraph 5.
 - c. Paragraph 7 has been amended to restate the coverage afforded in an affirmative way, with a reciprocal exception being added at Exclusion from Coverage 6.
 - d. Paragraph 8 has been amended to clarify that for an assignment of a mortgage to be insured, it must be shown in Schedule A.
- B. Exclusions From Coverage.
1. Owner's Policy.
- a. Paragraph 1 has been divided into subparts (a) and (b). Part (a) has been amended to add the words "laws" and "regulations" to the parenthetical to conform with the lead phrase so as to remove any ambiguity; for better organization, subheads (i) through (iv) have been added; subhead (iv) is a new addition to deal with environmental issues so as to specifically exclude them; and coverage has been broadened to the extent that the Company may not assert the Exclusion if notice of an excluded matter has been recorded in the public records at the Date of Policy.
 - b. Paragraph 1.(b) has been created from old Paragraph 2 by separating police powers from eminent domain. Again, the Exclusion is limited to unrecorded matters.
 - c. Paragraph 2 has been amended as noted above to remove the reference to police powers; coverage has been expanded to include the rights of a purchaser for value without knowledge of defects or problems not of record.
 - d. Paragraph 4 is a new Exclusion relating to creditors' rights. Simply stated, buyers and lenders generally are in a much better position to learn the financial status of a seller or borrower and have a responsibility to assume the risks entailed. That sort or credit analysis has not been a function of title companies.
2. Loan Policy.
- a. Exclusions 1, 2, 3 and 7 of the Loan Policy are reciprocal to Exclusions 1, 2, 3 and 4 of the Owner's Policy.
 - b. Paragraph 4 has been amended to add "inability" as an alternative to "failure" of the lender to comply with state doing business laws. Under present law in Illinois, this is of little importance as making loans is not within the definition of doing business.
 - c. Paragraph 5 is the relocation of the exception for usury, etc. transferred from Insuring Provision 5 of the 1970 form.
 - d. Paragraph 6 is the relocation and clarification of the mechanics' lien exception from Insuring Provision 7 of the 1970 form.
- C. Conditions and Stipulations. This section of the policy has been restructured, amended and expanded. The restructuring is intended to state these provisions in the order in which they ordinarily would be dealt with, especially in the event of a claim under the policy. The amendments mainly clarify and in most cases state those things which the 1970 policy implied. The expansion relates to specific provisions which change coverage and/or create new options.
1. Owner's Policy.
- a. Paragraph 1(f) amends the definition of "public records" to further clarify those which the Company is responsible for searching. While the industry would probably prefer to limit the definition even further, i.e., to a laundry list of county offices to be searched, that is not possible due to the wide variety of names applied to these offices across the country, not to mention the overlapping of functions that each may perform. The intent is to include records relating to real estate kept pursuant to state statute that create constructive notice as to a good faith purchaser for value.

A second change adds language concerning environmental protection liens filed in the office of the Clerk of the United States District Court for the district where the land is located. This is intended to compliment the language in Exclusion From Coverage 1(a) (iv) that promises to not exclude environmental protection matters of public record. In some jurisdictions that would be with the U.S. District Court Clerk. However, in Illinois this language is surplus because the appropriate filing site for such liens is the Office of the Recorder of Deeds (or Registrar of Titles for Torrens property in Cook County).
 - b. Paragraph 1(g) is a definition of "unmarketability of the title" and, while new to the policy, is a statement of the meaning traditionally given to the term. In short, it is such a condition that upon discovery would allow a buyer not to complete a contract of purchase.
 - c. The principal change in Paragraph 3 is to provide that the Insured must present any claim in writing and promptly. If the Company is prejudiced by the failure to notify, or to do so in a timely fashion, the Company is relieved of its liability under the policy, including the duty to defend, to the extent of its prejudice.
 - d. Paragraph 4(a) provides that the Company is free to select defense counsel subject to the Insured's right to object for reasonable cause. The Company's duty to defend is limited contractually to those matters arising under the policy coverages.
 - e. Paragraph 4(d) provides that the Insured must assist the Company in its defense of the title in the Insured. A failure to cooperate which prejudices the Company shall terminate the Company's liability to the extent of the prejudice.

- f. Paragraph 5 requires the Insured to provide the Company with a sworn statement as to the nature of the loss or damage such as by identifying the coverage under which the claim is made. The loss must also be quantified, including any formula that the Insured may have used in reaching a dollar sum. If documentation or records are possessed by the Insured which support or establish the claim, they must be made available to the Company for review and copying. Again, a prejudicial failure to cooperate shall relieve the Company of liability to the extent of the prejudice.
- g. The language in Paragraphs 6(a) and (b) has been amended to remove any doubt of the ability of the Company to settle with either the Insured or a third party. If a matter is settled, there no longer will be a duty to defend as to that matter.
- h. Paragraph 7 clearly identifies the policy as a contract of indemnity. In addition, Paragraph 7(b) adds a new coinsurance provision to the policy. Coinsurance provides that both the Insured and the Company share loss on a pro rata basis. Under the new policy, there are two situations to which coinsurance applies:
 - (1) Where the policy issues in an amount less than 80% of the value of the land at the Date of Policy, the Company will pay in the same proportion that the policy amount bears to the value. For example, if a policy issued for \$50,000 but the value of the land was \$100,000, should a loss of \$30,000 occur, the Company would pay \$15,000.
 - (2) Where the policy issues and thereafter improvements are made increasing the value of the property in excess of 120% of the policy amount, the Company will pay in the proportion that 120% of the policy amount bears to the policy amount plus the amount expended for the improvement. For example, if the policy issued for \$50,000, 120% of that amount would be \$60,000. If the amount expended for the improvement was \$70,000, that plus the policy amount would be \$120,000. The ratio applied to a loss would therefore be \$60,000/\$120,000 or 50%. If the loss were \$30,000, the Company would pay \$15,000.

It should be noted that neither appreciation nor inflation are factors in the valuation process and that the 20% (80% + 120%) variance up or down provides a comfortable margin. The invoking of the coinsurance clause does not diminish the responsibility of the Company to pay costs of defense.

- i. Under Paragraph 12(a), the Company may require production of the policy before a loss payment is made. Generally, the amount of the policy will be reduced by the amount of the loss payment. Under Paragraph 12(b), both liability *and* loss must be established before payment must be made.
- j. Paragraph 13, dealing with subrogation, has been changed in two ways:
 - (1) By way of clarification, it is provided that the Insured shall permit the Company to sue, compromise or settle in the name of the Insured.

- (2) A new provision (b) is added affirming the Company's rights to exercise the rights of the Insured under indemnities, guaranties, bonds or other policies of insurance.

- k. A major feature of the 1990 policies is the provision for Arbitration (Paragraph 14). This provides an alternative other than the judicial system for deciding disputes between the Insured and the Company. For policies in an amount of \$1,000,000 or less, either the Insured or the Company may demand arbitration. For policies in excess of \$1,000,000, both must agree. The American Arbitration Association has drafted special Title Insurance Arbitration Rules and copies are available upon request. For those parties wishing to restrict arbitration to situations where both the Insured and the Company are in agreement, an endorsement will be available on request to reduce the threshold sum (\$1,000,000) to one that would have that effect (such as \$1,000).

- l. Paragraph 16 is new. It simply reflects language of severability commonly found in contracts and agreement of all sorts.

2. Loan Policy.

- a. The definition of "insured" has been amended in two respects:
 - (1) An obligor under Paragraph 12(c) is excluded. This would preclude a private mortgage insurance company from succeeding to the interest of a mortgage under the policy.
 - (2) A purchaser for value of the indebtedness without knowledge attributable to the predecessor insured is not subject to the rights and defenses which the Company may have had against said predecessor.
- b. The amended definition of "public records" (Paragraph 1(f)) and the new definition of "unmarketability of the title" (Paragraph 1(g)) together with the changes to Paragraphs 3, 4, 5 and 6 are essentially the same as discussed under the Owners Policy.
- c. Paragraph 2 has been restructured to clarify what is insured in a lender after the lender acquires title. Of special note is the inclusion of the usual items of expense advanced by lenders for such things as real estate taxes, hazard insurance and repairs needed to preserve improvements.
- d. As in the Owners Policy, Paragraph 7 is prefaced by a statement that the policy is a contract of indemnity. There is no coinsurance language as was added to the Owners Policy.
- e. The comments applicable to Paragraphs 12, 13, 14 and 15 in the Owners Policy apply to Paragraphs 11, 12, 13 and 14 in the Loan Policy.

D. Schedules.

- 1. Schedule A. The only change in Schedule A is the addition of the words "Title to" as a prefix to Paragraph 3. This conforms the language in the Schedule to that in the Insuring Provisions.

2. Schedule B. The only change is the addition of a parenthetical noting that the Company won't pay costs or expenses arising from matters included in the General or Special Exceptions.

IV. Conclusion

The 1990 ALTA policy forms set a new standard for the industry, one which we believe goes a long way toward making

the coverage afforded clear and understandable. The better all of us, customers and title personnel, understand these coverages the better we will be able to serve you. At the same time, the numbers of disputes concerning coverage will hopefully be reduced, along with a resulting reduction in claims expense. An efficient, profitable title industry will allow for even more technological advances as we head for the 21st century and beyond. We thank you for your support which enables Chicago Title to continue to lead the title industry toward the future.

We are soliciting ideas for possible subjects for future *TITLE ISSUES*. If you are interested in submitting ideas for subjects, complete the form below and submit to:

Chicago Title Insurance Company

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