

TITLE ISSUES

SPECIAL TITLE INSURANCE ISSUES AND COVERAGES

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The discussion of title insurance coverage in this work is, necessarily, general and is intended only for informational purposes. It should not be construed as representing the position of any of the title insurers in the Chicago Title & Trust Company family under any particular set of circumstances. The policy provisions and endorsements discussed herein speak for themselves. Their text, not the views of the author, govern the coverages they provide or exclude.

As used in the notes, C&S means Conditions and Stipulations of the policy and EFC means Exclusions from Coverage of the policy.

COVERAGE OF LOAN POLICIES AFTER ACQUISITION OF TITLE

The American Land Title Association Loan Policies, past and present, all provide coverage for the insured lender after it acquires the title and extinguishes the mortgage lien. [C&S No. 2.(a)(i)] This is usually the result of a foreclosure or a deed in lieu of foreclosure but the same result might occur in a bankruptcy proceeding. However, this coverage does not benefit a third party purchaser at the foreclosure sale or a lender's affiliated corporation that takes the title through a deed in a workout arrangement. [C&S No. 2(a)]

Assuming there are no challenges to the foreclosure, the coverages are limited to the status of title to the property and the right of access. However, even though the coverage exists, it is not the equivalent of having a current owner's policy. There are three reasons:

First, the Date of Policy exclusion eliminates coverage for matters arising after the mortgage is made. [EFC No. 3.(d)] This means there is no coverage for the validity of the foreclosure or for any title defects to which the lender's title through a deed-in-lieu of foreclosure will naturally be subject.

Second, the loan policy contains a limitation of liability not found in an owner's policy: The amount of indebtedness created at Date of Policy which still exists at the time of a claim. [C&S No. 7.(a)(ii)] Therefore, mortgage payments reduce the maximum liability of the insurer to the extent they pay down the loan principal regardless of the face amount of the policy.

Third, the lender realized no loss compensable by the policy if the value of the previously mortgaged land and improvements exceeds the sum of the amount owed and the title defect in question. Consider the following example: The debt due at the time of foreclosure is

\$1 million; the value of the security, exclusive of the defect, is \$1.5 million and the title defect amounts to \$250,000. In this case, the Company would have no obligation to the lender for the defect because the value of the security it recovered was at least equal to its debt. This result is due to the indemnity contract nature of the policy. [C&S No. 7] The following cases appear to uphold this view: *Cale v. Transamerica Title Ins. Co.*, 225 Cal. App. 4th 972; 24 Cal. Rptr. 2d 912 (Cal. App. 1990); *Green v. Evisham Corp.*, 179 N.J. Super. 105; 430 A.2d 944 (N.J. Super Ct. App. Div. 1981); and *CMEI, Inc. v. American Title Ins. Co.*, 447 So. 2d 427 (Fla. Dist. Ct. App. 1984).

FAIRWAY ENDORSEMENT COVERAGE

A title insurer is not liable for losses to a claimant who does not fall into the definition of an insured under an owner's policy. [C&S No. 1] If the insured is a partnership which changes its partners in such a way as to create a new partnership which holds title to the property, the new partnership has no standing to make a claim. This is the holding of *Fairway Development Company v. Title Insurance Company of Minnesota*. [621 F. Supp. 120 (D.C. Ohio 1985)]

In *Fairway*, the title insurer took no exception for an easement encumbering the property. The insured partnership, created under the laws of Ohio, consisted of three partners. Two of them subsequently conveyed their partnership interests to the remaining partner and a third party purchaser. The business of the partnership was carried on by the remaining partner and purchaser under a new partnership agreement as required by Ohio statute.

The claim was filed thereafter. The title insurer denied liability on the basis that the claimant

was not an insured under the policy. The court upheld this denial on summary judgment, finding that the partnership making the claim was, in fact, a new partnership and not just a continuation of the original. While the court might have held so anyway, by the express terms of the new partnership agreement this was a new general partnership. [621 F. Supp. 120, 124]

This case resulted in myriad requests for endorsements from title insurers under which they would waive their rights to raise the defense. These are the so-called "Fairway Endorsements". Generally speaking, they come in two versions: One which waives the defense as to changes in a partnership already insured, and one which states the insurer will not raise the defense if specified changes are made in the future. A sample copy of each variety accompanies this paper. Neither of these endorsements insures that the change in partner relationships will not create a new partnership. Each merely waives a policy defense. [Exhibits A & B]

NON-IMPUTATION COVERAGE

Under the law of agency, the knowledge of an agent is imputed to the principal if it is within the scope of the purpose of the agency. Similarly, corporation law usually imputes to the corporation the knowledge acquired by the corporation's officers in their performance of their corporate duties. [18B Am Jur 2d Corporations Sec. 1671, citing *Indiana I. & I.R.Co. v. Swannell*, 157 Ill. 616, 41 NE 929 (1895)] The Uniform Partnership Act (UPA) makes the knowledge of partners the knowledge of the partnership if it is not being used to commit a fraud on the partnership. [UPA Sec. 12; 805 ILCS 205/12] This is a long standing rule. For a real estate example, in 1922, the Supreme Court of Appeals of Virginia imputed

the knowledge of an unrecorded easement to a partnership that purchased the land over which it ran. The reason was that, at the time of purchase, one of its partners was a former owner who knew of the easement. This was done to deny the partnership BFP status and was done without reference to the UPA, which was in effect at the time. [Buckles-Irvine Coal Co. v. Kennedy Coal Corp., 134 Va 1, 114 SE 233 (1922)]

The vast majority of recording acts in the country protect persons without actual notice of pre existing equities in real estate interests if they have no notice of the pre-existing equity. [6A Powell on Real Property, Par. 905[1][c][i] & [ii]] Either actual or constructive notice is sufficient to destroy the protection of these acts. [Id.] Both these principles apply under Illinois law. Imputed knowledge is a form of constructive knowledge. Therefore, an unknowing principal may not be protected by the recording laws against unrecorded interests in real estate if its agent knows of the unrecorded interest.

The ALTA title insurance policies are designed to be used in conjunction with the recording laws. Therefore, they exclude from coverage matters otherwise insured against which are not known to the insurer and not shown by the public records but are known to the insured and not disclosed to the insurer in writing. [EFC No. 3.(b)] Knowledge is defined as actual knowl-

edge, not knowledge derived from the public records. [EFC No. 1.(c)] Because the only way artificial entities like partnerships and corporations obtain knowledge is through the knowledge of their agents, the agent's knowledge must be their actual knowledge. [18B Am Jur 2d Corporations Sec. 1672, using logic that should apply equally to partnerships.]

The structure of many commercial real estate transactions today leaves one party or another vulnerable to the problem of imputed knowledge. As examples, partnerships are created in which the current landowner becomes a partner with new partner investors; partnerships are "rolled up", creating a new partnership which holds the assets of several prior ones. And the list goes on. The title insurance industry has met this problem with policy endorsements that waive the defense of the exclusion with respect to identified persons through whom knowledge may be imputed to the insured. An example accompanies this paper. [Exhibit C]

The coverage is underwritten principally by requiring the person who might have the relevant knowledge to do two things: To make disclosures of any knowledge of non record title defects they may have and to indemnify it from loss resulting from inaccuracies in them. Reputation and financial ability are obviously substantial factors in this kind of underwriting.

OWNERS
LOAN

ENDORSEMENT

Attached to and forming a part of

No. _____

Issued by
CHICAGO TITLE INSURANCE COMPANY

Partnership - Withdrawal or Replacement of Partners Endorsement

The Company agrees that it will not interpose as a defense to a claim of coverage under this Policy the fact that a dissolution of the insured partnership has occurred, or a new partnership has been formed solely by reason of the withdrawal or replacement of one or more of the partners of the original insured partnership on or before the date of this endorsement as long as the insured remains as the titleholder, and no new partnership is explicitly formed. The Company reserves all of its rights and defenses under the policy which it would have had against the insured or its constituent partners before or after such withdrawal or replacement.

The coverage provided for herein is limited to the effective date of the policy, to wit: _____ and is subject to the Exclusions from Coverage, the Schedules, and the Conditions and Stipulations of the policy, and any rights or defenses the Company would have had or may have against the named insured, or its successor partnership, or any constituent partners before or after any withdrawal, transfer, or substitution thereof.

This endorsement should not be construed as providing any insurance as to:

- (A) Matters attaching or created after the date of policy;
- (B) The status of the named insured after such withdrawal or replacement of partners; or
- (C) The validity or effect of such withdrawal or replacement of partners, whether by assignment or otherwise, including, but not limited to, the effect upon title to the land.

This endorsement is made a part of the commitment or policy. It is subject to all the terms of the commitment or policy and prior endorsements. Except as expressly stated on this endorsement, the terms, dates and amount of the commitment or policy and prior endorsements are not changed.

Dated:

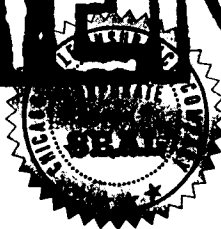
SPECIMEN

CHICAGO TITLE INSURANCE COMPANY

By:

Richard L. Pella
President.

Authorized Signatory



ATTEST:

Thomas J. Adams
Secretary.

Note: This endorsement shall not be valid or binding until countersigned by an authorized signatory.

OWNERS
LOAN

ENDORSEMENT

Attached to and forming a part of

_____ No. _____

**Issued by
CHICAGO TITLE INSURANCE COMPANY**

Partnership - Permitted Transfer Endorsement

Notwithstanding Paragraphs 1(A) or (2) of the Conditions and Stipulations, the Company agrees that in the event of loss or damage insured against under the terms of the policy, the Company will not deny liability under the policy to the named insured or any "Successor Partnership" (hereafter defined) solely by reason of a "Permitted Transfer" (hereafter defined).

A permitted transfer is a transfer of all or any part of the partnership interests of any one or more of the partners of the named insured or any successor partnership, if such transfer is to a "Designated Transferee" (hereafter defined).

A successor partnership is a partnership that results from a permitted transfer.

A designated transferee shall be:

The coverage provided for herein is limited to the effective date of the policy, to wit: _____, and is subject to the Exclusions from Coverage, the Schedules, and the Conditions and Stipulations of the policy, and any rights or defenses the Company would have had or may have against the named insured, or its successor partnership, or any constituent partners before or after any withdrawal, transfer, or substitution thereof.

This endorsement should not be construed as providing any insurance as to:

- (A) Matters attaching or created after the date of policy; or
- (B) The status of the named insured after any permitted transfer; or
- (C) The validity or effect of any permitted transfer, including, but not limited to the effect upon title to the land.

This endorsement is made a part of the commitment or policy. It is subject to all the terms of the commitment or policy and prior endorsements. Except as expressly stated on this endorsement, the terms, dates and amount of the commitment or policy and prior endorsements are not changed.

Dated:

SPECIMEN

CHICAGO TITLE INSURANCE COMPANY

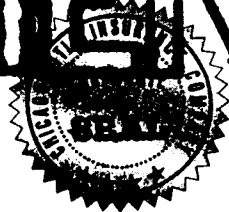
By:

Richard L. Pella
President.

Authorized Signatory

ATTEST:

Thomas J. Adams
Secretary.



Note: This endorsement shall not be valid or binding until countersigned by an authorized signatory.

OWNERS
LOAN

ENDORSEMENT

Attached to and forming a part of

_____ No. _____

Issued by
CHICAGO TITLE INSURANCE COMPANY

Attached to and forming a part of Policy of Title Insurance No.

The Company hereby assures _____ notwithstanding the terms of the Conditions and Stipulations or schedule of Exclusions from Coverage to the contrary, that in the event of loss or damage insured against under the terms of the policy, the Company will not deny its liability thereunder to said insured on the grounds that said insured had knowledge of any matter solely by reason of notice thereof imputed to it through _____ by operation of law.

The total liability of this Company under said policy and any Endorsements therein shall not exceed, in the aggregate, the face amount of said policy and costs which the Company is obligated to pay under the Conditions and Stipulations.

This endorsement is made a part of said Policy and is subject to the Schedules, Exclusions from Coverage, and Conditions and Stipulations therein, except as modified by the provisions of this endorsement.

IN WITNESS WHEREOF, the Company has caused its corporate name and seal to be affixed by its duly authorized officers.

SPECIMEN

This endorsement is made a part of the commitment or policy. It is subject to all the terms of the commitment or policy and prior endorsements. Except as expressly stated on this endorsement, the terms, dates and amount of the commitment or policy and prior endorsements are not changed.

Dated:

CHICAGO TITLE INSURANCE COMPANY

By:

Richard L. Pella
President.

ATTEST:

Thomas J. Adams
Secretary.

Authorized Signatory

Note: This endorsement shall not be valid or binding until countersigned by an authorized signatory.

