TITLE INSURANCE POLICIES - What are They? What Do They Do? 1

The basic coverage afforded by a typical title insurance policy is to indemnify the insured owner or lender for loss caused by a defect in title that existed on the date the policy was issued (or the commitment given) unless the defect is expressly excluded from coverage. Although the concept of title insurance is a simple one to understand the practice of insuring titles has given rise to a considerable volume of litigation in the United States. One can speculate that the less rigorous conveyancing practices which may be associated with the use of title insurance are the basis of at least some of this litigation.

Although the title insurer will usually carry out a search of title (and may be required by law to do so), the policy will usually not recognize any separate obligation to search the title. Some lenders, of course, require the insurer to provide title information presumably for the purpose of allowing for their own assessment of the state of the title. The practice of conducting a title search and in providing title information has given rise to a considerable amount of U.S. litigation against title insurers involving claims founded in negligence and not brought under the insurance contract. Many of these claims involve allegations that the insurer failed to disclose title defects to the insured. These types of actions are usually triggered where the insured is unhappy with his contractual remedies. For instance, the claim may exceed the limits of the policy or involve damages which are excluded (e.g., emotional distress or punitive damages). A unique problem may also arise where the insured would not have purchased the property

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had she known about the title problem. United States courts have been sharply divided in their willingness to allow tort-based litigation against title insurers. Those courts which have endorsed causes of action founded in negligence have done so primarily on the basis of a recognition that title insurers are suppliers of information and have a corresponding duty of care in carrying out that function. Other U.S. courts have relied upon the existence of a statutory obligation to conduct a title search before issuing a policy as the basis for imposing tort liability.

One of the leading American decisions supporting a collateral claim in negligence is the 1975 California Court of Appeals decision in *Jarchow v. TransAmerica Title Insurance,* 122 Cal.R. 470. In that decision, the court held that the insurer's liability could extend to punitive damages, damages for emotional distress, or damages which exceeded the limits of the insurance policy. In California the *Jarchow* decision was subsequently overturned by legislation but has, nevertheless, constituted the basis for similar holdings in other states.

This line of judicial reasoning could easily be extended in Canada on the basis of previous Supreme Court of Canada authority. That Court has already recognized a plaintiffs right to bring collateral claims in tort and in contract (see *Central Trust v*. Rafuse (1986) 31 D.L.R. (4th) 481) and has imposed tort liability on an insurer for its failure to provide adequate coverage information

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to its insured (see *Fletcher v. Manitoba Public Insurance* (1990) 74 D.L.R. (4th) 636).

As with most common law insurance issues, there is a competing line of American authority holding that the liability of a title insurer is limited to its contractual undertakings. One of the leading U.S. decisions supporting such a liability limitation was handed down by the New Jersey Supreme Court in *Walker Rogge Inc. v. Chelsea Title and Guarantee Company* (1989) 562 A. (2d) 208. There the insured alleged that the title insurer negligently failed to search its own records which would have disclosed that the size of the lot that was being purchased was less than anticipated. The title insurance policy in that case was based upon the standard form published by the American Land Title Association (ALTA) which provided that the insurer made no express contractual undertaking to examine the title to the property. The underlying rationale stated by the New Jersey Court for limiting a title insurer's liability to its contractual obligations included the absence of a contractual undertaking to search the title and a recognition that the essence of the transaction

was only to obtain indemnity and not information. The Court went on to hold that the insurer had the right to limit its liability by contract. Presumably a properly worded contractual limitation would have the same effect in Canada (see *Central Trust v. Rafuse, supra)*

Contentious Area of Litigation in the United States The Scope of Coverage

One of the commonly asserted advantages to title insurance over a solicitor's certificate of title is the essential character of the title insurance policy as a primary agreement to indemnify the insured with no requirement to establish negligence. However, there is U.S. jurisprudence holding that a title insurer is not obligated to initiate an action to protect a title nor is it obligated to indemnify the insured for those defects until there has been a "final determination" as to their validity: see Eliopoulos v. *Nation's Title Insurance of New York Inc. (1996) 912 F.S. 28.* In that case, among a number of title defects, the insured complained about the existence of several encumbrances to the property which, if they were valid, would render the existing subdivision unlawful with a reduction in the economic value of the property. The insured asked the insurer to rectify the title defect but the insurer refused to do so. The holders of the encumbrances had not initiated any legal action challenging the insured's title and, in the result, no duty to defend had arisen. The Court took a very restrictive view of coverage and held that the insured's recovery was limited to situations where the insured had been sued by a competing claimant or where the insured successfully launches his own suit to protect his title interests.

The Eliopoulos decision may be wrongly decided because it seems to contradict the widely accepted principle that title insurance coverage for "actual

loss" in an owner's policy means the difference between the expected value of the insured's estate or interest in the land and the value of the insured's estate or interest subject to the defect, lien or encumbrance insured against. Presumably this means that the existence alone of a quantifiable diminishment in fair market value should trigger the indemnity obligation. If the insured must sue or be sued to remove a title defect, the supposed advantage of title insurance as an indemnity for loss over a solicitor's certificate becomes illusory.

There are important distinctions to be made between the coverage afforded under a typical lender's policy and that afforded under an owner's policy. On occasion, American courts have lost sight of that distinction. Under a lender's policy, the loss is usually measured by the lender's out-of-pocket loss. This can be an extremely important distinction. The case of *Marble Bank v. Commonmwealth Land Title Insurance (1996) 914 F.Supp.* 1252, involved a policy of title insurance protecting the bank's interest as the holder of a third mortgage in the amount of $2 million. The bank's interest was allegedly compromised because of a loss of priority due to the existence of a number of mechanics' liens in the amount of $3.5 million. The Court held that the insured had the burden of proof regarding its loss and must establish that the value of the project exceeded the obligations under the mortgage. The Court determined that the relevant date for measurement of the real property's value was the date of the foreclosure sale and not the date of the discovery of the liens. The Court determined that the fair

market value of the project at the date of foreclosure was only $7.5 million which was less than the combined amounts due under the three mortgages. The Court, therefore, ruled that the insured had not sustained a loss and was caught by the exclusion applying to encumbrances which resulted in "no loss or damage to the insured claimant."

In some U.S. jurisdictions title insurers have a practice of issuing a binding commitment in advance of the issuance of the actual policy of insurance. The commitment is typically given at the time of closing with the actual policy to be issued subsequently. In circumstances where a title defect arises during the intervening period between the giving of the

commitment and the issuance of a policy, title insurers have attempted to either limit their exposure or to get off the risk entirely. In the recent case of *MacDonald v. Lawyers Title Insurance* (1996) 95-1220 U.S.A. pp. LEXIS 4505, the Appeal Court held that the title insurer was obligated to issue a policy in accordance with the initial commitment which had not identified the proposed insured and where the policy limits were "to be determined." The Court stated:

By using these words ["to be determined"] instead of leaving these provisions in Schedule "A" blank, the parties to the Commitment indicated that they had reached some sort of agreement as to the identity of the proposed insured and the amount of the policy. What is ambiguous is the meaning of the words "to be determined". When we consider the customary practice in Virginia, however, it is clear what the parties meant. The identity of the proposed insured

and the amount of the policy are determined by the high bid at the foreclosure sale.

This type of reasoning is generally consistent with the Canadian experience in the life insurance field where interim binders are frequently issued during the time when medical investigations are being completed and before the policy is issued. Attempts by life insurers in that situation to either eliminate or limit their exposure have not always received judicial endorsement.

It has also been held in California that there is no public policy requirement for a title insurer to issue a title insurance policy on any particular piece of property. In *Quelimane v. Stewart Title* (1996) 54 Cal.R. (2d) 364, the Court of Appeal affirmed a trial decision which had held that a conditional commitment for title insurance did not oblige the title insurer to subsequently issue a policy of insurance to the owner in a situation where a sale of the property had fallen through. In a recent discussion that I have had with a conveyancing practitioner he made the somewhat facetious comment that he would be happy to arrange for title insurance on several properties in Nova Scotia where the title was substantially clouded. We may find, in fact, that title insurers are extremely reluctant to issue policies with respect to certain parcels of land or in areas where the title situation is clouded and lawyers' certificates of title may in those situations remain the only available option

Coon Exclusions

Acts of the Insured

The failure by the insured to give timely notice of the existence of a title defect as required by the policy may, if the insurer is thereby prejudiced, result in a loss of coverage. In the case of *Wainco Funding v. First American Title* (1995) 631 N.Y.S. (2d) 81 (A.D.), the Court ruled that a 20 month delay which prevented the insurer from intervening in a tax lien proceeding gave the insurer an effective defence to the claim under the policy.

Defect Created, Suffered, A, Assumed or Agreed to by the Insured

This is an exclusion which is not uncommonly relied upon by title insurers. Where the insured creates, suffers, assumes or agrees to a title defect, there is no coverage. The provision is sufficiently vague that it can be difficult to apply except in the clearest of cases. Where the insured's conduct appears dishonest or where the existence of the defect is within the control of the insured (such as a judgment) the exclusion will often be enforced. However, mere knowledge of a defect by the insured will not be a sufficient basis for applying the exclusion. Two cases which provide some insight into the application of this exclusion are *Insured Title Inc. v. McDonald* 911 P. (2d) 209 and *American Savings & Loan v. Lawyers Title Insurance* 793 F. (2d) 780.

Survey Exception

Although title insurance is frequently used as a substitute for the requirement for a survey, there are policies which contain a survey exception and which deny coverage for any encroachments, easements, measurements, variations in area or content,

party walls or other facts that a correct survey of the premises would show. This type of exclusion was successfully used by a title insurer which refused to defend its insured in connection with a suit by a neighbour over an allegedly encroaching fence. On appeal, the Court held that the survey exception was intended to exclude coverage for errors that would be revealed by an accurate survey of the insured property: see *American Title Insurance v. Carter 670 So.* (2d) 1115.

Where such an exception exists in the policy, conveyancing counsel should be careful to continue to recommend to purchasers that either a location certificate or a survey be obtained.

Restrictive Covenants

Title insurance policies frequently contain an exclusion for subdivision plan restrictions or restrictive covenants. This can be a serious gap in the protection afforded by title insurance. In the case of *Delessio v. Williams* (1996) Ohio App. LEXIS 2011, the Court used this exclusion as the basis for denying coverage to an insured under an owner's title policy in a suit which

attempted to enforce covenants pertaining to boundary line setbacks and minimum building requirements. The insurer refused to defend the insured in the enforcement action and that off coverage position was upheld.

Liability of Title Insurer to Third Parties

For the most part, U.S. courts have resisted claims by third parties to obtain benefits under tide insurance policies. That resistance has been supported in part by the absence of any privity between third parties and the insurer. However, to the extent that our own jurisprudence is somewhat more liberal in finding duty of care obligations and to the extent that title insurers can be found to be negligent in the provision of title information, I would suggest that there is some potential in this country for successful third party litigation against title insurers.

Conclusion

Based upon the U. S. experience, there is really no reason to think that title insurance will reduce the level of litigation associated with real estate conveyancing. Indeed there is every reason to believe that title insurers will be no more generous in their treatment of first party claims than the insurance industry generally. There are sufficient exclusions and exceptions in the typical title insurance policy to generate at least as much litigation as has been the case in connection with solicitors' certificates, not to mention the potential for subrogation litigation against lawyers and other third parties involved in the title investigation process.

TABLE OF AUTHORITIES