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Preface

Most California real property transactions include the issuance of a title insurance company product. Owners generally obtain title insurance on acquisition of real property, lenders require the borrower to pay for a lender's policy if the loan is secured by real property, and lessees under long-term leases also seek title insurance coverage. The first edition of this book was written to provide basic information on title insurance to attorneys handling real estate transactions to help them counsel their clients on the various title insurance options available.

This second edition is intended to further that goal, not only by providing a more thorough analysis of commonly used title insurance products (preliminary reports, binders, insurance policies, endorsements, and guaranties) and by expanding the discussion of products specifically designed for owners and lenders, but also by dispelling lingering confusion on the scope of title insurance coverage and by providing a comprehensive look at the basis for claims involving title insurance and how such claims may be pursued and defended. Examples and practice tips throughout the book show practitioners how to choose the right product for their client and how to protect the client's interests when disputes arise.

An attorney handling real property transactions will also want to consult CEB's related real property publications, *e.g.*, California Real Property Sales Transactions (4th ed Cal CEB 2007), California Real Estate Finance Practice: Strategies and Forms (Cal CEB 2000), California Mortgages, Deeds of Trust, and Foreclosure Litigation (4th ed Cal CEB 2009), and the California Real Property Law Reporter (published six times a year). On litigation issues that may arise in connection with title insurance practice, see California Liability Insurance Practice: Claims & Litigation (Cal CEB 1991), California Mechanics' Liens and Related Construction Remedies (3d ed Cal CEB 1998), California Civil Procedure Before Trial (4th ed Cal CEB 2004), and California Real Property Remedies and Damages (2d ed Cal CEB 2002).

CEB is profoundly grateful for the efforts of the authors and consultants who gave generously of their time and talents in writing, revising, reviewing, and commenting on the manuscript. The authors' names are listed on the title page; biographical footnotes appear at the beginning of their respective chapters. The consultants' names are listed on the Acknowledgments pages.

CEB is fortunate to have had the assistance of Rod Pasion in planning and overseeing this book. Mr. Pasion is a Vice President and Associate Regional Counsel with Chicago Title Company in San Francisco. He brought his extensive knowledge of the title insurance industry to bear on the material in this book. As chief consultant, he reviewed and commented on each chapter. Mr. Pasion also cowrote chapter 3, providing insight on the workings of underwritten title companies and title insurance companies.

The project supervisors for this book were Johanna Sherlin and Janis LaRoche Blanchette. Legal editing was performed by CEB attorneys Janis LaRoche Blanchette, Bonnie C. Maly, and Dianne M. Millner. Special editorial assistance was provided by Rebecca De Kalb. In addition, Bonnie C. Maly contributed substantial portions of original writing to chapters 11, 12, and 14.

Legal research analysis was provided by Carolyn Valley, assisted by Maria Borje-Bonkowski, Bettina M. Fernández, and Ken Marr. Akanke Peyton provided administrative assistance. CEB senior editors Cinda Ely and Maryann Aberg handled copyediting and production. The book was designed by Cheryl Ventimiglia. Robert W. Burke, Jr., prepared the index. Composition was performed by CEB's Electronic Publishing staff.

September 2009 Update

CEB would like to thank the author of this update, Timothy R. Sullivan, of McLaughlin Sullivan LLP, Fresno.

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In Memoriam

Theodore R. Forrest, Jr.

On May 26, 2001, CEB lost a long-time contributor and supporter, Theodore R. ("Ted") Forrest, Jr. Ted established the Consumer Fraud Division of the Fresno County District Attorney's office and was responsible for prosecuting hundreds of civil and criminal consumer fraud matters. He then went into private practice, and was the founder and senior partner of Forrest, Henderson, Sloan and Davis in Fresno, California. A graduate of San Joaquin College of Law in Fresno, Ted maintained close ties with his alma mater, acting as Secretary and Trustee, as well as adjunct professor for the law school. Over the years, he also taught at Humphrey's College of Law in Fresno, Fresno City College, and California State University—Fresno ("Fresno State"). Ted continued his academic contributions to the practice of law as coauthor of Environmental Health Law (Praeger Publishers 1984), and as a coauthor of California Title Insurance Practice (2d ed Cal CEB 1997).

Ted also served as a judge pro tem and arbitrator for the Fresno County Superior Court. He was a member of the Fresno County and American Bar Associations, the State Bar of California, the Association of Trial Lawyers of America, the Association of Defense Counsel of Northern California, the Defense Research Institute, and was on the board of directors of the Central California Association of Business Trial Lawyers. He was respected throughout the legal community as a courageous advocate for all his clients and was involved in matters throughout California and several other states.

Ted is survived by his wife and childhood sweetheart, Susan Forrest, and their seven sons. He will be remembered as a loving, dedicated husband and father, an avid golfer, a bad singer, and a good friend.

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Selected Developments

September 2009 Update

This update includes a discussion of the statutory and case law developments occurring since the previous update, as well as an examination of other materials, such as arbitration rules. Of particular interest are the following:

Case law, statutory, and regulatory developments. Insurance Code §§12418-12418.4 have been added, regulating title marketing representatives. See §1.8.

Certain advertising and food and entertainment expenditures have been added to the list of activities in Ins C §12404(c) that are considered per se inducements to obtain business and are unlawful. See §1.13.

An "inclusionary housing development" may contain deed restrictions designed to keep the property affordable to buyers with very low to moderate income. *Alfaro v Community Hous. Improvement Sys. & Planning Ass'n* (2009) 171 CA4th 1356, ___ CR3d ___. See §4.7.

In *Kwok v Transnation Title Ins. Co.* (2009) 170 CA4th 1562, 89 CR3d 141, when the named insured under a title insurance policy was an LLC formed by the Kwoks, a transfer of the property by deed to the Kwoks as trustees of their family trust served to terminate coverage under the policy. See §6.61.

Under *Philip Morris USA v Williams* (2007) 549 US 346, 355, 166 L Ed 2d 940, 949, 127 S Ct 1057, a jury may consider evidence of harm to others in determining the degree of reprehensibility of the defendant's conduct for purposes of determining punitive damages. However, a state court may not award punitive damages for the purpose of punishing a defendant for harm caused to nonparties to the litigation. See §11.35C.

In *McCoy v Progressive W. Ins. Co.* (2009) 171 CA4th 785, 90 CR3d 74, the trial court properly refused to give two jury instructions relating to the genuine dispute doctrine, holding that the doctrine is subsumed within the concept of what is reasonable and unreasonable as set forth in CACI 2331 and 2332. See §11.103A.

In *Bouton v USAA Cas. Ins. Co.* (2008) 43 C4th 1190, 1199, 78 CR3d 519, the court overruled *Van Tassel v Superior Court* (1974) 12 C3d 624, 627, 116 CR 505, which had held that an arbitrator may decide "jurisdictional facts," including the status of the claimant as an insured. See §14.3.

In *Brodke v Alphatec Spine Inc.* (2008) 160 CA4th 1569, 1574, 73 CR3d 554, defendants' petition to compel arbitration was denied because they did not adequately allege the existence of a valid agreement to arbitrate. See §14.5.

The court in *Cronus Investments, Inc. v Concierge Svcs*. (2005) 35 C4th 376, 25 CR3d 540 held that CCP §1281.2(c), allowing the stay of either arbitration proceedings or a concurrent lawsuit, did not conflict with the Federal Arbitration Act (FAA) (9 USC §§1-16) and did not undermine the FAA policy favoring arbitration; the FAA therefore did not preempt CCP §1281.2(c). See §14.12.

Parties to a contractual arbitration may take themselves out of the general rule that the merits of an award are not subject to judicial review if they clearly agree that legal errors are an excess of arbitral authority that is reviewable by the courts. *Cable Connection, Inc. v DIRECTV, Inc.* (2008) 44 C4th 1334, 1361, 82 CR3d 229. See §14.47.

Arbitration Rules. The 2008 version of the National Arbitration Forum's Code of Procedure (COP Rules) went into effect August 1, 2008, and applies to any claim filed on or after that date. Discussion of the 2008 version is incorporated into the discussion of the COP Rules. See chap 14.

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Cutoff Dates and CEB Citation

Cutoff Dates

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Organization and Regulation of Title Industry

Oscar H. Beasley

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- B. What Title Insurance Does
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I. INTRODUCTION TO TITLE INSURANCE

§1.1 A. Brief History of Title Insurance

Until a hundred years or so ago, conveying real property, although relatively simple by today's standards, did not include any form of guaranty or insurance. Many of the transactions were handled by conveyancers, some of whom were attorneys, who either personally searched the title or obtained a title search or a form of abstract to ascertain ownership of the property and to discover any encumbrances on the title. Historically, before taking title to the property, the buyer required that title be free of any existing rights, interests, liens, or encumbrances for which the buyer would be responsible. Based on the title search or the abstract, the title could be examined and an opinion rendered by an attorney (or the conveyancer, if an attorney), stating whether title was marketable. The need for title insurance arose when traditional methods of conveying failed to provide safety to buyers or lenders.

In 1868 the court in *Watson v Muirhead* (1868) 57 Pa 161 held that the conveyancer was not negligent when he chose to ignore, following a good faith consultation with an attorney, the existence of recorded judgments. The innocent purchaser, who suffered financial damage because of the encumbrances on title, had no recourse against the conveyancer or anyone else. As a direct result of this decision, the Pennsylvania legislature enacted a law that incorporated and regulated title insurance companies. Thereafter throughout the country, many title insurance companies were organized to insure purchasers against losses from title defects, liens, and encumbrances.

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B. What Title Insurance Does

§1.2 1. Covers Past Events

The word "insurance" means an agreement to pay for loss or damage arising from an event occurring within the prescribed time of the agreement (policy). Most forms of insurance protect the insured against the occurrence of a prospective event such as a fire that burns a building or a driver who injures a pedestrian. Title insurance does not. If the problem does not affect title to land or improvements, it is not covered by title insurance. Title insurance does not cover a leaky roof or hot water heater and does not cover plumbing or kitchen appliances. Nor does it cover future title problems. Rather, it covers only past events that affect title of the party being insured, except for any past events that the policy specifically excludes or excepts.

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Source: Real Property/California Title Insurance Practice/1 Organization and Regulation of Title Industry/§1.3 2. Covers Matters Affecting Title

§1.3 2. Covers Matters Affecting Title

Title insurance provides coverage against loss or damage (1) caused by a matter in existence at the time the policy is issued, (2) that affects the title to the property, and (3) that was not excluded or excepted from the policy.

> "Title insurance" means insuring, guaranteeing or indemnifying the owners of real or personal property or the holders of liens or encumbrances thereon or others interested therein against loss or damage suffered by reason of:
> (a) Liens or encumbrances on, or defects in the title to said property;
> (b) Invalidity or unenforceability of any liens or encumbrances thereon; or
> (c) Incorrectness of searches relating to the title to real or personal property.

Ins C §12340.1.

Title insurance insures:

- The validity of the owner's or leaseholder's title;
- The validity, enforceability, and priority of the lender's lien; and
- The validity, enforceability, and priority of:
- easements, covenants, conditions, and restrictions,
- assignments and royalties, and
- many other real-property-related instruments or matters.

On the scope of coverage of owner's and lender's policies, see §§6.7-6.11, chaps 7-8. Title insurance products can also be used to insure several other matters, including:

- Access (see §§6.27, 7.72-7.73, 8.59-8.60);
- Zoning (see §§6.36, 7.97-7.98, 8.101); and
- Loss or damage arising from the violation of covenants, conditions, and restrictions on the use of property (see §§7.80-7.83, 8.71-8.72).

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II. ORGANIZATION, OPERATION, AND REGULATION OF TITLE INDUSTRY

§1.4 A. Organization and Operation of Industry

In general, the title insurance business is conducted through the use of direct branches of title insurance companies, underwritten title companies (sometimes referred to as title company agents), approved attorneys, or attorney agents. A branch of a title insurance company is not the same as an underwritten agent. It is merely the title insurer issuing its own policy through the use of its own employees.

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§1.5 1. Underwritten Title Company or Title Agent

An underwritten title company or title agent is an agent of the title insurance company. It issues policies in connection with its contractual relationship with one or more title insurance companies in accordance with specific underwriting guidelines established between the agent and its insurance underwriter. The policy issued by the underwritten title company or the title agent binds the title insurance company even though it is not directly involved with the issuance of the policy to the insured. If a claim is made, it is referred directly to the title insurance company for handling and paying. In California, underwritten title companies usually represent and act as agents for only one title insurer, but in many other states it is more common for agents to represent many title insurance companies. On underwritten title companies, see §§3.2-3.5.

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Source: Real Property/California Title Insurance Practice/1 Organization and Regulation of Title Industry/§1.6 2. Approved Attorney

§1.6 2. Approved Attorney

An "approved attorney" is generally not considered an agent of the title company but instead has authority to issue title opinions on which the title insurer can rely. Generally, the attorney has no right to actually issue the policy. Approved attorneys are not found in California but are common in other parts of the United States.

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§1.7 3. Attorney Agents

Attorney agents are most prevalent in the northeastern, eastern, and southeastern parts of the country. In several states, a title opinion can be issued only by an attorney, and as a result, the attorneys become direct agents of the title insurance company. An entire firm or an individual attorney may be the agent.

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§1.8 B. Regulation of Industry

The title industry is generally a state-regulated industry. The state of domicile has the most comprehensive regulation of a company, but nondomestic insurers are subject to substantial regulation by all states in which they offer insurance.

California regulates both title insurance companies (Ins C §§12340-12388, 12390-12418.4) and underwritten title companies (Ins C §§12389-12389.6). Domestic and foreign title insurance and underwritten title companies must file proposed policies and premiums with the Department of Insurance before they are used in the marketplace. Title companies must establish basic classifications of coverages and services on which to base their rates. Ins C §12401.2. On price regulation, see §3.15. California statutes govern capitalization, deposits, and reserves. See §1.9. Both California and federal statutes regulate rebates, kickbacks, and commissions. See §§1.13-1.14.

California also regulates underwritten title companies (the independent title agent of title insurance companies) by requiring specific minimum net worth requirements. See §1.10.

In addition, California regulates "title marketing representatives," meaning persons employed by a title insurer, underwritten title company, or controlled escrow company whose primary duty is to market, offer, or sell title insurance. Ins C §§12418-12418.4.

The Insurance Commissioner provides a brochure for residential real estate title insurance consumers to advise them that competing title insurers and underwritten title companies may offer different premiums and/or services related to the title insurance requirements of their transaction, as well as discounts and short-term rates. Ins C §12406.5. The brochure encourages consumers to compare the costs and services of different insurers and it informs consumers about the laws involving unlawful commissions and rebates. Consumers are encouraged to report any such activities to the Insurance Department, the Department of Real Estate, or other government agencies. The brochure is posted on the Insurance Department's Internet site. See Directory for address.

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§1.9 1. Regulation of Title Insurance Companies

A title insurer is any company that issues title policies as insurer, guarantor, or indemnitor. Ins C §12340.4. Title insurance companies are regulated by Ins C §§12340-12388, 12390-12418.4. Policies may cover both real and personal property titles. Ins C §§12340.1-12340.2. Title insurance is a "mono line" form of insurance, which is held separate and apart from property and casualty lines. An insurer who transacts any other type of insurance business in the United States cannot conduct a title insurance business in California. Ins C §12360.

Any title insurer doing business in California must provide a guarantee fund of $100,000 for the security and protection of the holders of, or beneficiaries under, its title policies. Ins C §12350. In addition, any title insurer doing business in California must have paid-in capital represented by shares of stock of at least $500,000. Ins C §12359. Most significant, other reserves must be set aside as follows:

- A title insurance surplus fund consisting of an amount equal to 10 percent of its premiums collected during the past year until the amount collected equals the lesser of 25 percent of the aggregate of the subscribed capital stock of the insurer or $1 million. Ins C §12370.
- An unearned premium reserve fund (generally known as statutory premium reserve), which is set at an amount equal to 4.5 percent of all gross title income less reinsurance cost, if any. These reserves provide additional protection for policy holders. The statutes contain a release clause, which permits payments to be returned to the insurer over a period of years if the fund is not needed. Ins C §§12380-12388.
- The insurer is required to carry substantial reserves for its policy holders to cover claims as they arise. Many states also require an added reserve for claims that are known and claims that are in existence but not reported. This latter category covers claims that may be known, for instance, to an insured but not to the company (incurred but unreported claims). Ins C §12388.

Title companies are also prohibited from accepting rebates, kickbacks, or commissions. Ins C §§12404-12413.5. See §§1.13-1.14.

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Source: Real Property/California Title Insurance Practice/1 Organization and Regulation of Title Industry/§1.10 2. Regulation of Underwritten Title Companies

§1.10 2. Regulation of Underwritten Title Companies

An "underwritten title company" is any corporation engaged in the business of preparing title searches, title examinations, title reports, certificates, or abstracts of title that serve as the basis for a title insurer to write title policies. Ins C §12340.5. Underwritten title companies are governed by Ins C §§12389-12389.6, 12418-12418.4.

To be licensed to do business in California, underwritten title companies must meet established net worth requirements. "Net worth" is defined as the excess of assets over all liabilities and required reserves. The amount of net worth required depends on the number of documents recorded and filed in the office of the county recorder in the preceding calendar year in all the counties where the company is licensed to transact business. The more documents that are recorded, the higher the net worth required. In addition to net worth are many important requirements on audits, deposits, and maintenance of records, receipts, and disbursements. Ins C §12389. The underwritten title company is also prohibited from accepting rebates, kickbacks, or commissions. Ins C §§12404-12413.5. See §§1.13-1.14.

See *Quackenbush v Superior Court* (1997) 57 CA4th 660, 67 CR2d 300, holding that, when an underwritten title insurance company has violated the Insurance Code, Ins C §12389 does not impose a mandatory duty on the Insurance Commissioner to notify the public or prohibit the company from doing business unless the Commissioner first gives notice, holds a hearing, and finds a willful violation of that section.

The primary reason for these laws is to provide a measure of safety for customers using an underwritten title company. On underwritten title companies generally, see §§3.2-3.5.

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§1.11 3. Concerns Regarding Closing by Underwritten Title Company

While the title insurance company conducts and is directly responsible for activities of a branch of the company, that is not true for underwritten title companies and agents. The title insurance company is not liable for the agent's activities pertaining to closing, including the holding and disbursing of funds, handling of documents, abiding by and following the instructions of the insured, or other related issues. Because of this limited liability, many insureds are reluctant to deliver money to agents or approved attorneys for fear that a loss, if it did occur, would not be the responsibility of the title insurance company, and that a small agent would not have the financial ability to pay damages. This concern is addressed by the use of a closing protection letter between the title insurance company and the lender, the use of subescrow accounts, or both. On closing protections letters generally, see §3.5. On subescrows, see §§3.30, 10.3.

NOTE: If the underwritten title company is placed into bankruptcy, receivership, or conservatorship and there is a shortage in a subescrow or escrow account, the title company will be liable if it has entered into an underwriting agreement with the underwritten title company. Ins C §12376.

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§1.12 4. Regulation of Escrow Companies

In Southern California (and other parts of the country), escrow and closing services are performed by independent escrow companies, which are not connected to title companies. Independent escrow companies not owned or controlled by either a title underwriter or an underwritten title company are regulated by the Department of Corporations under the Escrow Law (Fin C §§17000-17002). On the Escrow Law, see California Real Property Sales Transactions, chaps 2, 15 (4th ed Cal CEB 2007).

Controlled escrows are controlled or owned by a title underwriter or an underwritten title company and are regulated by the Department of Insurance. Ins C §12340.6. Bank escrows and escrows controlled by a Realtor or a developer are exempt from the Escrow Law (Fin C §17006), while bank escrows are under the general supervision of the Department of Banking (as authorized by Division 1 of the Financial Code) and escrows controlled by a Realtor or a developer are regulated by the Department of Real Estate (10 Cal Code Regs §§2950-2951).

In instances in which the escrow is not controlled by, or directly part of, the title industry, the title company's only function is to issue the title insurance policy. In many transactions, lenders fund through the title company rather than through the independent escrow companies, by using subescrows. See §§3.30, 10.3. Subescrows are used because buyers and lenders believe that regulated title insurance companies are more financially stable and more tightly regulated than independent escrow companies. In subescrows, the title company controls funds. It pays off liens on the property as instructed before issuing its policy and sends any remaining funds to the escrow agent for disbursal.

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III. PROHIBITION OF REBATES, KICKBACKS, AND COMMISSIONS

§1.13 A. California Statutes

California, as well as many other states, has undertaken to control the market conduct of underwriters and underwritten title companies. Insurance Code §§12404-12413.5 sets guidelines on rebates, kickbacks, and commissions.

> It is unlawful for any title insurer, underwritten title company or controlled escrow company to pay directly or indirectly, any commission, compensation or other consideration to any person as an inducement for the placement or referral of title business.

Ins C §12404(a). Actual placement or referral of title business is not a precondition to a violation of this section.

Insurance Code §12404(c) lists activities that are considered per se inducements to obtain business and are unlawful. They are:

> (1) Paying or offering to pay, furnishing or offering to furnish, or providing or offering to provide assistance with the business expenses of any person, including, but not limited to, rent, employee salaries, furniture, copiers, facsimile machines, automobiles, telephone services or equipment, or computers.
>
> (2) Providing or offering to provide any form of consideration intended for the benefit of any person, including cash, below market rate loans, automobile charges, or merchandise or merchandise credits.
>
> (3) Placing or offering to place on behalf of any person, compensating balances.
>
> (4) Advancing or paying or offering to pay money on behalf of any person into an escrow to facilitate the closing thereof, other than any sum which represents the proceeds of a loan made in the ordinary course of business and in compliance with [Insurance Code] Section 1176; or an advance not to exceed 2 percent of the sales price of the real property being sold or exchanged through the escrow or the amount of any loan secured by real property involved in the escrow, whichever is greater; or the extension of credit or an advance for the costs, fees and expenses of the escrow or of the title insurance issued or to be issued in connection therewith.
>
> (5) Disbursing or offering to disburse on behalf of any person escrow funds held by a title insurer, underwritten title company or controlled escrow company before the conditions of the escrow applicable to that disbursement have been met, or in a manner which does not conform to [Insurance Code] Section 12413.1, including disbursing or offering to disburse before the expiration of the appropriate period established in [Insurance Code] Section 12413.1.
>
> (6) Furnishing or offering to furnish all or any part of the time or productive effort of any employee of the title insurer, underwritten title company, or controlled escrow company to any person for any service unrelated to the title business.
>
> (7) Advertising or paying for the advertising in any newspaper, newsletter, magazine, or publication that is produced by, or on behalf of, a person, or that results in a direct, or indirect, subsidy to a person.
>
> (8) Expenditures for food, beverages, and entertainment for a person.

Unlawful rebates are prohibited (Ins C §12405) as are payments for certain promotional materials and evidence of title (Ins C §12405.7) and commissions for the solicitation or negotiation of services constituting the business of title insurance (Ins C §12408.5). These comprehensive statutes are designed to prevent the buying of business by either insurers or underwritten title companies. The statutes give the Department of Insurance the right to examine the company's books, records, and accounts (Ins C §12407) and to impose a penalty in an amount equal to a minimum of $5000 or five times the amount of any commission or unlawful rebate (Ins C §12409). The statutes also provide other remedies, including suspension or revocation of authority. Ins C §12411. See also Ins C §§12410, 12928.6, 12976.

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Source: Real Property/California Title Insurance Practice/1 Organization and Regulation of Title Industry/§1.14 B. Federal Statutes; RESPA

§1.14 B. Federal Statutes; RESPA

The Real Estate Settlement Procedures Act (RESPA) (12 USC §§2601-2617), enacted in 1974 and later amended, prohibits the payment or retention of kickbacks or unearned fees in transactions involving a "federally related mortgage loan." A federally related mortgage loan is defined as a loan (other than a temporary loan) that is secured by a first lien on residential real property designed principally for occupancy by one to four families and that is made by certain lenders. Nearly all institutional lenders are included in the statute's description of the class of lenders to which RESPA applies. 12 USC §2602(1).

Regulations that are promulgated by HUD (24 CFR §§3500.1-3500.21 and Appendixes A-MS-2 (Regulation X)) and interpreted by the courts provide guidelines to the applicability and enforcement of this law. The RESPA and its accompanying regulations and amendments make many forms of rebate a violation. In enacting RESPA, Congress expressed the intent to outlaw "kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services." 12 USC §2601(b)(2). The RESPA prohibits parties from giving or accepting any fee, kickback, or thing of value incident to a settlement service that involves a federally related mortgage unless such fee or payment is related to services rendered or goods provided. 12 USC §2607(a).

A "settlement" means any service provided in connection with the prospective or actual settlement of a RESPA-related transaction, including, but not limited to, each of the following (12 USC §2602(3)):

- The origination, processing, or funding of a federally related mortgage loan, including mortgage brokerage services;
- Title services;
- Legal services;
- Document preparation;
- Credit reports and appraisals;
- Inspections;
- Conducting settlement;
- Mortgage, flood, and homeowner's insurance;
- Homeowner's warranties;
- Required credit life and disability insurance;
- Tax services;
- Real estate brokerage services; and
- Any other service for which a settlement service provider requires a borrower or a seller to pay.

Although in both the state and federal arenas the actual prosecution of violators seems limited, many settlements have been entered into by various violators and substantial fines paid. For further discussion of RESPA, see California Real Property Sales Transactions §15.95 (4th ed Cal CEB 2007).

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IV. OTHER FORMS OF ASSURANCE IN OTHER PARTS OF UNITED STATES

§1.15 A. Abstracts

In several of the eastern states, a practice developed before title insurance became available that based title opinions on the use of abstracts. An abstract of title is a condensed history of the title to land, consisting of a synopsis or a summary of the materials or operative portion of all the conveyances, of whatever kind or nature, that in any manner affect the land or any estate or interest in it, together with a statement of all liens, charges, or liabilities to which the land may be subject and that may be material in the purchase of the land.

Abstractors check the county records and make abstracts or take actual copies of each item that the abstractor believes affects the land. When completed, the abstract is typically examined by an attorney, or in the states where permitted, by a title agent or an insurer. Abstracts are seldom used in California. On abstracts, see §5.25. Preliminary reports are *not* equivalent to abstracts and do not provide the same information on title to the property. Ins C §§12340.10-12340.11. On preliminary reports generally, see chap 5. On the differences between abstracts and preliminary reports, see Ins C §§12340.10-12340.11 and §§5.25-5.27.

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§1.16 B. Attorney's Opinion

If an abstract is used or an attorney makes a title search, the attorney opines on whether the title is marketable or lienable. Unlike a title insurance policy, the attorney's opinion focuses on acquisitions risks, not insurability. If the attorney rendering the opinion is wrong, then the issue of malpractice may arise, based on the standards of the bar association or of the community. Attorney opinions on title are rare in California. See §2.36.

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2

Advising Clients About Title Insurance

Alice L. Akawie

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I. ADVISING CLIENTS

§2.1 A. Determining Scope of Representation

The attorney's role in advising the client about title insurance varies, depending on the transaction and the client. Sales and loans are the most common transactions involving title insurance matters. Occasionally, leasehold interests are also insured. An attorney representing one party in a transaction should be aware of not only his or her obligations but also those of the attorney for the other side. This understanding will help the attorney explain to the client the scope of his or her legal representation and the tasks to be addressed in the fee agreement with the client. On the attorney's role in real property sales transactions generally, see California Real Property Sales Transactions, chap 1 (4th ed Cal CEB 2007).

An attorney who represents a client in a real property transaction is often involved in a due diligence investigation for the client. The scope and nature of that investigation depend on such factors as the type of transaction, the value of the property, and the sophistication of the client. The attorney should be certain that the client understands the parameters of the attorney's role in the transaction. Some clients expect the attorney to undertake and direct a thorough due diligence investigation while others want the attorney to assume a limited role and undertake only specific tasks. The attorney may be responsible for contacting and coordinating other professionals and service providers. In title insurance, this process should begin as early as time permits. Early contact with the title insurer allows an assessment of both the viability and costs associated with a proposed transaction while there is still time for modification of the parties' positions. Often, underwriting concerns can be addressed at an early stage with a minimum of cost to the parties. If left until late in the transaction, however, such problems may be more difficult to solve.

This chapter focuses on the attorney's role in reviewing the preliminary report and negotiating insurance coverage in sales, loan, and leasehold transactions. On due diligence in sales transactions, see Real Property Sales §§1.58-1.93 and Land Use and Environment Forum 86-109 (Cal CEB Spring 1996). On due diligence in loan transactions, see California Real Estate Finance Practice: Strategies and Forms, chap 8 (Cal CEB 2000).

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B. Explaining Limitations of Title Insurance

§2.2 1. Dispelling Misconceptions

Attorneys and clients both hold numerous misconceptions about title insurance. The attorney should attempt to dispel such misconceptions by understanding the nature of title insurance and explaining to the client how it works. See §§1.2-1.3. See also §13.4.

Some of the more common misconceptions about title insurance include the following:

- That the preliminary report represents the current state of title to the property. It does not. Neither the preliminary report nor the title policy contain representations of the state of title. The preliminary report is an offer to issue insurance subject to specific exclusions and exceptions. See §§5.1, 5.26-5.27.
- That title insurance is similar to casualty insurance. It is not. Rather, it is "risk avoidance" insurance that provides indemnity coverage to the insured for loss or damage directly incurred by the insured, or incurred as a result of a third party claim, from a covered risk that exists on the date of the policy. See §§2.23, 6.2, 6.20.
- That the term "public records" as currently defined in title policies is synonymous to the chain of title. It is not. Public records include documents that provide constructive notice. Not every recorded document in the chain of title provides constructive notice. See §§4.7-4.8.

Attorneys should also advise clients that title insurance companies are not required to issue title policies and will not do so when the company finds the risks presented by the transaction unacceptable. Although the California Supreme Court held in *Quelimane Co. v Stewart Title Guar. Co.* (1998) 19 C4th 26, 77 CR2d 709 that a real property purchaser who had been denied title insurance coverage by multiple title companies for a tax-defaulted property had stated a cause of action for unfair competition and intentional interference with contractual relations under the circumstances presented in that case, the court also confirmed that "[a]n insurer does not have a duty to do business with or issue a policy of insurance to any applicant for insurance." The court left it to the legislature to decide whether title insurance should be required to be issued for particular risks. 19 C4th at 43.

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Source: Real Property/California Title Insurance Practice/2 Advising Clients About Title Insurance/§2.3 2. Informing Clients That Certain Matters May Not Be Disclosed

§2.3 2. Informing Clients That Certain Matters May Not Be Disclosed

The title industry has standardized provisions of title policies through the California Land Title Association (CLTA) and the American Land Title Association (ALTA), which develop and publish the most widely used forms. Certain matters affecting title may not be disclosed in a title policy or in any other title company product because of:

- The type of policy ordered (standard coverage or extended coverage);
- Title plant errors that may not fall within contemplated coverage; or
- Underwriting decisions that are covered by off-record indemnity agreements.

EXAMPLE: Assume that a title company's public records search discloses a lis pendens or abstract of judgment recorded against the property. If the seller provides the title company with an indemnity agreement, the title company may not show the lis pendens or abstract of judgment as an exception on the preliminary report. The prudent title company may elect instead to disclose the existence of the lien and insure over it through use of an endorsement. If the transaction involves a federally insured lender, the failure to disclose may violate the Program Fraud Civil Remedies Act (31 USC §§3801-3812), which gives the Department of Housing and Urban Development and other agencies the authority to impose civil penalties for false statements and false claims.

Such facts and circumstances may affect the client's decision about whether to proceed with the transaction. For this reason, an attorney whose role includes a complete review of title should consider the preliminary report to be only the starting point of his or her work in this area.

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II. ROLE OF ATTORNEYS IN SALES TRANSACTIONS

§2.4 A. Ordering Preliminary Report

The buyer occasionally asks the attorney to recommend a title company. More often, in a residential transaction, the buyer's real estate agent recommends a title insurer. In a commercial transaction, the seller may select the title insurer or the parties may negotiate the selection of the insurer. On selection of the title insurer generally, see chap 3. In any case, the first step after selection of the insurer is to order a preliminary report. On preliminary reports generally, see chap 5.

The person who orders the preliminary report must be prepared to provide the following information:

- Location of property, legal description, tax assessment number, and name of current owners;
- Type of transaction (*e.g.,* sale, lease, loan, work-out, loan modification, option);
- Purchase price, loan amount, or other description of proposed policy amount;
- Proposed timeline of transaction;
- Number of sites involved and, if applicable, allocation of policy amount among sites;
- Date of last title insurance policy issued on the property, if known;
- Whether any sale or refinance is anticipated to occur in the near future;
- If known, the type of policy desired, coverage reinsurance or coinsurance requirements (see §§3.7-3.14), special endorsements (if not known immediately, this information should be given to the insurer as soon as possible); and
- Other services required (*e.g.,* escrow or coordination services).

This information enables the insurer to provide an early assessment of underwriting issues and a quote for the title insurance premium and any additional services to be provided. The matters discussed in this book are intended to assist the attorney in determining and defining the coverage and services to be requested.

PRACTICE TIP: Unless specifically requested to do so, the title company does not provide a copy of each of the underlying documents summarized as exceptions in the preliminary report. When ordering a preliminary report, the attorney should request a copy of these underlying documents. If time is a factor in a closing, the attorney should also obtain an estimate for delivery of the preliminary report and the underlying documents from the title company at the time the order is placed and request that delivery be made on a rush basis. Although a preliminary report can often be generated in one week, a difficult or complex title search will take longer.

If the buyer does not initiate contact with the title company, the buyer's attorney should require that the seller provide the buyer with a copy of the preliminary report and each of the underlying documents within a specified period of time.

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B. Reviewing Preliminary Report

§2.5 1. Buyer's Attorney

Reviewing the preliminary report is an important step in structuring a transaction. The review may disclose that title is vested in someone other than the seller. It may help the buyer's attorney to ascertain whether an exception to coverage will create an impediment to closing because of the monetary cost to remove it, the length of time it will take to remove it, or the parties' inability to remove it. These factors can impact the value of the property to the buyer. The attorney will need to explain to the buyer the impact, if any, of the various exceptions on the value and use of the property. On preliminary reports, see chap 5. For further discussion of removal of exceptions to coverage, see California Real Property Sales Transactions §§4.111-4.131, 15.52 (4th ed Cal CEB 2007).

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§2.6 a. Reviewing Exceptions to Coverage

Unless an exception is minor or the seller has agreed in writing to remove it on or before close of escrow, the buyer's attorney should carefully review all underlying documents summarized as exceptions to determine whether they are acceptable to the buyer or endorsements are available (and acceptable to the buyer) that afford affirmative coverage over perceived risks created by the exceptions. On exceptions to coverage, see §§5.9-5.24.

A minor exception is one that will not interfere with the use of the property or reduce its value. For example, a utility easement located across the rear five feet of the property is a minor exception if there are no structures on the easement and the easement area is not needed for access. An exception likely to be handled in the purchase agreement is a deed of trust that must be reconveyed before the buyer takes title to the property.

Many of the exceptions in the preliminary report are stated in broad and generic terms because the insurer lacks the information necessary to narrow the scope of the exception. The attorney should ascertain whether information is available that will enable the title company to limit the scope of such exceptions.

EXAMPLES: The generic exception for "any facts that a survey would disclose" is frequently found in a preliminary report issued in expectation of the issuance of an extended coverage policy. A title company can narrow this exception to refer only to specific survey items after the insurer reviews a recent ALTA survey of the property. On surveys generally, see §§4.30-4.34. A broad exception for "rights of parties in possession" can be modified or deleted in some instances (1) on delivery to the title company of an owner's affidavit and a certified rent roll or (2) after the title company's inspection of the property. The exception can then be limited to specified tenants occupying the property under unrecorded leases.

By reviewing the underlying documents and insisting on a careful definition of the exceptions to coverage, the attorney will be able to inform the client of the nature and scope of matters affecting coverage and to lessen the likelihood that the client will purchase unnecessary endorsements. Review of the exceptions may disclose unexpected benefits. Covenants, conditions, and restrictions may confer reciprocal easements unknown to the buyer. In such instances, the attorney should have the title company amend the preliminary report to reflect those reciprocal easements in the description of the subject property.

PRACTICE TIP: The attorney should make a request for amendment of the preliminary report early in the process. The insurer will need time to search the title of the servient estate before issuing additional coverage.

More frequently, the review of exceptions discloses unexpected problems. For instance, a loan that the buyer intended to assume may be secured by a deed of trust with a due-on-sale clause, requiring the loan to be paid in full on transfer of title. The property could be subject to an easement that restricts access or prohibits the buyer's proposed development. Common exceptions to coverage include the following:

- Easements (see §5.10);
- Encroachments (see §5.11);
- Covenants, conditions, and restrictions (see §5.12);
- Deeds of trust and other financing instruments (see §5.13);
- Leasehold interests (see §§5.24-5.17); and
- Tax liens (see §5.18).

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Source: Real Property/California Title Insurance Practice/2 Advising Clients About Title Insurance/§2.7 b. Comparing Underlying Documents With Summary of Exceptions

§2.7 b. Comparing Underlying Documents With Summary of Exceptions

The attorney should compare the underlying documents with the summary of exceptions to coverage set forth in the preliminary report and have the title company correct any inconsistencies.

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§2.8 c. Confirming Vesting

The attorney should confirm that the party executing the purchase and sale agreement either is the same person shown as the vested title holder on the preliminary report or is authorized to bind the vested title holder. See §§2.29-2.35 for means of confirming the authority to act.

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§2.9 2. Seller's Attorney

The seller's attorney reviews the preliminary report to determine which exceptions to coverage must be removed before close of escrow to satisfy the terms of the purchase agreement and in anticipation of the buyer's objections to title. Common exceptions requiring the seller's attorney to act include deeds of trust, expired leases, terminated options and rights of first refusal, and mechanics' liens. The attorney may also have to determine whether (a) permission is required for existing encroachments or (b) the encroachment has become permanent. See CCP §321; *Kafka v Bozio* (1923) 191 C 746, 218 P 753.

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§2.10 a. Reconveying Deed of Trust

If the property is encumbered by a deed of trust, the attorney must first ascertain whether (1) it will be reconveyed at closing or (2) the buyer will either assume the loan or take title subject to it. If the deed of trust will be reconveyed, the escrow agent (which may also be the title company) will routinely request that the lender deliver a beneficiary statement to escrow.

PRACTICE TIP: The beneficiary statement or demand, prepared by the lender, generally states the amount of money (principal, interest, and any other fees) due and payable to the lender before the deed of trust can be reconveyed (or partially reconveyed). If the demand is not time limited (*e.g.,* when a discount is provided if repayment is made by a certain date), the amount due should include a per diem rate so that if escrow is delayed by a few days, the escrow holder can calculate the amount due without obtaining another beneficiary statement from the lender. The attorney should obtain a copy of the beneficiary statement and have the seller review it to confirm that the amount of the payoff demand is correct. If it is not, the attorney may need to deal with the lender to correct the demand.

Occasionally, a beneficiary does not respond to the title company's request for a beneficiary statement because:

- The beneficiary does not understand the request (which is often the case with private party lenders without much experience in real estate transactions);
- There is some dispute between the borrower and lender; or
- The beneficiary cannot be located.

In such cases, the attorney typically must become involved. If the beneficiary simply does not understand the process, the attorney can explain that (1) the need to deposit the original documents will not compromise the beneficiary's security interest and (2) instructions can be given to the title company that the deposited documents may not be used until the full payoff amount is held in escrow. The seller's attorney should confirm with the beneficiary that it will provide the original promissory note, deed of trust, and request for reconveyance in a timely manner. For further discussion of reconveyances, see California Mortgages, Deeds of Trust, and Foreclosure Litigation §§8.92-8.99 (4th ed Cal CEB 2009).

PRACTICE TIP: Civil Code §2941.7 provides a means for obtaining release of the lien of the deed of trust by use of a corporate bond, which may be necessary if the beneficiary fails to reconvey.

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§2.11 b. Transferring Subject to Deed of Trust

If the buyer will assume or take title subject to the deed of trust, the seller's attorney must confirm that the proposed transaction will not violate any terms of the deed of trust, including any due-on-sale or due-on-encumbrance provision. For further discussion of financing restrictions on transfer, see California Mortgages, Deeds of Trust, and Foreclosure Litigation §§8.19-8.24 (4th ed Cal CEB 2009).

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§2.12 C. Removing Exceptions to Coverage

After the title review and following consultation with the buyer, the attorney or buyer's agent will request (or, if permitted by the purchase agreement, require) the seller to remove certain exceptions to coverage before close of escrow. Generally, a buyer will not want to take title subject to monetary liens or encumbrances and defects that interfere with the buyer's proposed use of the property. For further discussion of exceptions, see §§5.9-5.24.

PRACTICE TIP: This notification should be given within the time permitted by the purchase contract because purchase contracts commonly provide that failure to notify the seller is deemed to be a waiver of objections to title. Following this advice is particularly important when using preprinted residential deposit receipts.

If the seller is responsible for removing any exceptions to coverage, the seller's attorney should confer immediately with the title officer, who can identify which documents may be needed to remove an exception or which endorsements may be available.

PRACTICE TIP: If a title officer is unable to help resolve a title issue or delete an exception, the attorney should pursue the matter first with the county manager and then with in-house counsel or the chief underwriter.

If an adequate endorsement can be issued, the buyer may allow certain exceptions to remain even if they would be difficult, costly, or time consuming to remove. For example, an old unlocatable easement that could be removed only by a quiet title action might remain as an exception if the insurer issued a CLTA 103.1 endorsement. See §§8.75-8.76.

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Source: Real Property/California Title Insurance Practice/2 Advising Clients About Title Insurance/§2.13 D. Arranging for Inspection and Survey of Property

§2.13 D. Arranging for Inspection and Survey of Property

The standard coverage policy does not cover off-record matters such as tenants in possession, encroachments, rights of adverse possession, or prescriptive rights not of record that could be discovered by an inspection of the property. The buyer's attorney, therefore, should consult with the buyer about the need to inspect the property. A buyer who is acquiring raw land for commercial development, for instance, should do the following if the size and nature of the transaction warrant it:

- Have a knowledgeable person make a careful inspection of the property and conduct any necessary tests;
- Obtain an ALTA survey of the property; and
- Obtain an extended coverage policy.

If a survey of the property is available, the attorney may want to review it. The survey may provide valuable information about the property by reflecting the location of the improvements in relation to the boundaries and the easements burdening the estate. On the need for a survey for an extended coverage policy, see §2.18. For further discussion of ALTA surveys, see §4.32.

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§2.14 E. Evaluating Need for Commitment

The buyer's attorney should decide whether to request that the title company issue a commitment binding the title company to issue a title policy. On commitments, see §§5.31-5.38.

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F. Determining Appropriate Coverage

§2.15 1. Advising Buyer

An important step for the attorney to take is to evaluate the various title risks to the client and reduce those risks by shifting them, if possible, to the title insurance company. This task may be accomplished by obtaining the appropriate title policy and endorsements for the client. To undertake this evaluation, the attorney must understand the structure of the transaction, the proposed use of the property, and the type of coverage (standard or extended) needed by the client. On title insurance issues important to owners, see chap 7.

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Source: Real Property/California Title Insurance Practice/2 Advising Clients About Title Insurance/§2.16 a. Determining Buyer's Knowledge of Off-Record Matters

§2.16 a. Determining Buyer's Knowledge of Off-Record Matters

The attorney should solicit any information regarding title that the buyer may know that is not of record. (The title insurance policy does not protect the insured if the insured knows of a matter not of record and does not disclose that matter in writing to the title company. For further discussion of this exclusion, see §6.42.)

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Source: Real Property/California Title Insurance Practice/2 Advising Clients About Title Insurance/§2.17 b. Recommending Type of Policy

§2.17 b. Recommending Type of Policy

The attorney should explain to the client the scope of coverage afforded by the standard coverage and extended coverage policies, recommend endorsements, and explain what the title insurer will require before issuing the policy.

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Source: Real Property/California Title Insurance Practice/2 Advising Clients About Title Insurance/§2.18 (1) Explaining ALTA Survey Requirement

§2.18 (1) Explaining ALTA Survey Requirement

An extended coverage owner's policy generally requires an ALTA survey, which increases the cost of the transaction and may delay closing unless a relatively current survey already exists (on ALTA surveys, see §4.32). Thus, an extended coverage policy may not be appropriate for the transaction. On the differences between standard and extended coverage policies, see §§6.6-6.11.

PRACTICE TIP: Obtaining an ALTA survey is time consuming. The attorney should advise the buyer early in the transaction whether to obtain an extended coverage policy. Sometimes the attorney can overcome cost and timing problems created by the need for a survey by having an old survey recertified or by obtaining the insurer's agreement to waive the survey. The factors considered by a title company in evaluating whether to provide such a waiver include the following:

- The location, nature, and age of any improvements;
- The type of legal description (recorded map or metes and bounds);
- Whether the coverage being sought is owner's or lender's coverage (with lender's coverage, the risk of a claim based on the survey is mitigated if substantial equity exists); and
- The availability of other information sources (*e.g.,* old subdivision or parcel maps or recorded surveys).

Some attorneys report that, because of increased competition, title companies are more willing now than in the past to waive the survey requirement in residential transactions.

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Source: Real Property/California Title Insurance Practice/2 Advising Clients About Title Insurance/§2.19 (2) Addressing Options With Title Officer to Meet Buyer's Needs

§2.19 (2) Addressing Options With Title Officer to Meet Buyer's Needs

Satisfying the buyer's need for a particular form of coverage may be approached in different ways. The attorney can discuss the client's goals with the title officer and solicit various suggestions on how to solve a coverage problem.

EXAMPLE: If the property is multi-parcel, high-acreage farmland that would be too costly to survey, two choices are available if the insured desires coverage over parties in possession and mechanics' liens. First, the insured could purchase a standard coverage policy (which contains a preprinted survey exception) with the appropriate endorsements, which would provide affirmative coverage over the parties in possession and mechanics' liens exceptions. Second, a less costly approach might be to purchase an extended coverage policy with the addition in Schedule B of a survey exception. In providing a survey on only those parcels of the farm that are improved with structures (*e.g.,* a home, barn, or warehouse), the insured could have the survey exception modified to affect only the unimproved parcels.

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§2.20 c. Recommending Endorsements

With a basic understanding of the coverage afforded by the title policy, the attorney may choose from a vast array of endorsements to expand or modify the basic terms of the policy, thereby tailoring the coverage to satisfy the insured's specific needs. Endorsements are riders attached to title insurance policies to expand or restrict coverage, insure over policy risks, or modify the policy's conditions and stipulations. Depending on the structure and nature of each transaction, endorsements can be applied to all segments of the policy from the general insuring provisions and exclusions to the schedule of exceptions and the conditions and stipulations:

- Access rights in the general insuring provisions can be expanded with the issuance of a CLTA 103.7 endorsement. See §§7.72-7.73.
- Affirmative coverage on zoning and Subdivision Map Act compliance excluded in paragraph 1 of the exclusions from coverage can be provided with CLTA endorsements 123.2 and 116.7, respectively. See §§7.97-7.98, 7.94-7.96.
- Risks associated with Schedule B exceptions disclosing covenants, conditions, and restrictions or easements can be reduced with CLTA endorsements 100.5 and 103.3, respectively. See §§7.80-7.83, 8.75-8.76.
- If an insured deed of trust secures payment of a revolving line of credit, a CLTA 111.11 endorsement is necessary to adequately modify paragraph 8(a) of the conditions and stipulations to provide continuing coverage for subsequent draws on the credit line. See §§8.61-8.62.

In addition to the standard CLTA endorsements, special title company endorsements are available to fit a wide variety of situations. On special endorsements for owners, see §§7.65, 7.100-7.103.

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§2.21 2. Advising Seller

If the seller provides financing to the buyer, the attorney may assist the seller in selecting the appropriate form of lender's coverage and endorsements. The attorney may advise on the difference between a CLTA joint protection policy and an ALTA extended coverage policy. See §§2.40-2.47 for further discussion of the role of the lender's attorney.

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§2.22 G. Negotiating Coverage

Because a title insurance policy is a contract, it is subject to negotiation. The parties may negotiate, *e.g.,* the type of policy to be issued, the exceptions to be listed, and the wording of endorsements. As early in the process as possible, the attorney should begin any necessary negotiations with the title company. Negotiations may be conducted by the buyer's attorney, the seller's attorney, or both. On negotiating exceptions to coverage, see §§5.21-5.24.

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§2.23 1. Understanding Nature of Title Insurance

To successfully negotiate coverage issues with the title insurer, the attorney must understand the basic nature of title insurance as that of "risk avoidance" insurance as opposed to "casualty" insurance. Unlike casualty insurers (who set aside most of the premium charged for future loss reserves), title insurers necessarily use 80 to 90 percent of the premium collected to cover expenses incurred in producing the product and underwriting the coverage requested.

A title insurer who issues coverage equivalent to that of casualty insurance will not remain solvent long because the statutory reserves required to be set aside for future losses will not be sufficient to cover expected claims. Indeed, the cost of an endorsement often covers the cost of research needed to determine that the perceived risk will ultimately not lead to future monetary loss to the insured.

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§2.24 2. Resolving Title Issues

Even when operating under the assumption that title insurance is risk avoidance insurance, the attorney may disagree with the title insurer over the nature and extent of the risk associated with issuance of the requested coverage. When this happens, several options are available to the insured's attorney. See §§2.25-2.27.

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Source: Real Property/California Title Insurance Practice/2 Advising Clients About Title Insurance/§2.25 a. Contacting Title Company Attorney

§2.25 a. Contacting Title Company Attorney

The title company attorney plays a key role in resolving title issues, which may range from determining whether an uninsured deed is issued to a bona fide purchaser for value to determining whether the title company is willing to eliminate or narrow certain exceptions. The attorney may assist in establishing the structure of the transaction in order to make title insurance available.

EXAMPLE: A title company may be unwilling to insure a transaction that arguably involves a hidden security device, *e.g.,* an unrecorded deed of trust encumbering the property. The title company's attorney may help the parties eliminate the aspects of the transaction that create the problem or convert the transaction into a true loan.

The attorney may also advise the title company on the risks involved in writing over exceptions or issuing endorsements.

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§2.26 b. Appealing to Other Decision Makers

All title insurance companies are organized with a hierarchy of decision makers. An insured's attorney can appeal a negative decision to a higher underwriting source within the local office where the transaction is being processed or, for more complex title issues, use the insurer's underwriters residing at the company's regional or home offices. This process can lead to an attentive and complete analysis of the particular risk and to a discussion between the attorney and the underwriters of possible ways to restructure the transaction to avoid the risk altogether.

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§2.27 c. Contacting Competitors

An attorney can also contact other title insurance companies to determine whether another insurer is willing to issue the requested coverage. If the answer is in the affirmative, the original insurer will often acquiesce and issue the desired coverage. If the original insurer holds to its initial decision, the transaction can be moved to the insurer willing to provide the necessary coverage.

The switch to another insurer can be problematic if there is insufficient time before the closing for the new insurer to complete its own search and examination necessary to prepare a preliminary report. In high-liability transactions requiring reinsurance, the new insurer's agreement to insure can be a Pyrrhic victory if other insurers refuse to issue reinsurance. On reinsurance and retrocession, see §§3.8-3.10.

PRACTICE TIP: If efforts to obtain the desired coverage are unsuccessful, the attorney should advise the client of the ramifications created by the uninsured risk and investigate sources of insurance outside the title industry that may cover the specific risk at issue.

Endorsements, indemnity agreements, and funds retained in escrow are all methods of resolving title problems. On owner's endorsements, see chap 7. On indemnity agreements, see §5.41. On funds retained in escrow, see §5.42.

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§2.28 H. Budgeting Costs

Either the buyer or the seller may request the attorney to assist in estimating title and escrow costs. One cost, of course, is the title policy premium. See §§3.15-3.27. Other costs include recording fees and government transfer taxes. The latter can be significant. In addition to the county transfer tax, many cities now impose separate transfer taxes. The title insurer can help the attorney determine whether and how a city imposes such a tax. Timely disclosure of this information can help the buyer realistically estimate closing costs.

PRACTICE TIP: Some cities impose a transfer tax on only the equity being transferred. In these cases, a buyer who takes subject to the existing financing can avoid substantial tax, effectively paying tax only on its down payment.

Identifying costs may also help the buyer negotiate the payment of such costs. In residential transactions, county custom typically determines which party pays the title insurance premium, transfer taxes, and escrow fees. In commercial transactions, this responsibility is generally a matter of negotiation. For a discussion of the customary division of closing costs, see California Real Property Sales Transactions §§15.43-15.46 (4th ed Cal CEB 2007).

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§2.29 I. Establishing Authority to Act

One of the title insurer's primary concerns is to confirm the authority of the parties to any transaction to convey the property, take title, or borrow funds. Thus, a party's attorney may be asked to establish the existence and the authority of a party to execute documents. Generally, title companies are concerned about an individual's authority to execute transfer documents binding on the seller. If the title company is providing lender's insurance at the time of closing, the title company may also request proof of authority from the borrower. Although this section focuses on the seller, the same documents will be needed if a buyer or borrower is required to prove its authority to act.

PRACTICE TIP: If a new entity is being formed to purchase the property, the attorney must make sure that all appropriate steps are taken to bring the entity into existence before close of escrow.

If the seller is an entity, the seller's attorney must review, approve, and provide to the title company evidence of the seller's existence and authority to convey the property. (If the seller is an individual, he or she must provide certain informational statements and affidavits, discussed in §2.34.) To prevent the client from making misrepresentations in the purchase or loan documents about the prerequisites taken, prudent attorneys will investigate the scope of authority.

PRACTICE TIP: If a vote of limited partners is required for the sale of partnership property, the seller's attorney should not permit the seller to represent in the purchase agreement that the prerequisites have been met if there were flaws in the solicitation of ballots or the requisite number of votes was not obtained. Having been sued by disgruntled limited partners, title companies have become increasingly careful about ascertaining the existence of authority. If the requisite authority to sell was not present and the limited partners are unhappy about losses they suffered on the property sale, they may see both the title company and the attorney as convenient targets. Similar issues of authority arise when a corporation or trust is involved in a transaction.

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1. Entities and Individuals

§2.30 a. Partnerships

For limited partnerships, title companies generally require a certified copy of the certificate of limited partnership (LP-1), filed with the Secretary of State's office in conformance with the California Revised Limited Partnership Act (Corp C §§15611-15723). For foreign limited partnerships, the title company requires a certified copy of the limited partnership's certificate of registration (LP-5) and a certificate of good standing issued by the California Secretary of State.

The title company requires a copy of the underlying partnership agreement if evidence is necessary to:

- Establish authority for fewer than all the general partners to execute documents binding on the partnership; or
- Determine the limited partner's role in those matters set forth in Corp C §15636(f), which, absent an agreement to the contrary, cannot occur without the affirmative vote of all or a majority in interest of the limited partners.

On limited partnership authorization documents, see Advising California Partnerships §§5.25-5.30 (3d ed Cal CEB 1999).

For general partnerships, a recorded statement of partnership is necessary. The title company will request a copy of the partnership agreement, if necessary to establish authority for fewer than all the general partners to execute documents. On general partnership authorization documents, see Advising Partners §§4.38-4.44.

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§2.31 b. Corporations

The corporate authorization documents required by title companies are certified copies of articles of incorporation, corporate resolutions authorizing the transaction, a certificate of good standing issued by the Secretary of State (frequently directly ordered by the title company), and a certificate of incumbency.

For a foreign corporation, documents from the corporation's state or country of incorporation is necessary to establish that the corporation was validly formed and that its legal existence was not suspended or forfeited for any reason. Confirmation may also be required from the California Franchise Tax Board that the rights and privileges of the corporation have not been forfeited for failure to pay taxes or for any other reason.

On corporate authorization documents, see Sales and Mergers of California Businesses (Cal CEB 2002); California Real Property Sales Transactions §§4.28, 10.65 (4th ed Cal CEB 2007).

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§2.32 c. Limited Liability Companies

To prove authority to act for a limited liability company, a certified copy of articles of organization (LLC-1, for domestic companies; LLC-5, for foreign companies), a copy of the operating agreement, and possibly resolutions authorizing the transaction will be required.

On a limited liability company's authorization to act, see Forming and Operating California Limited Liability Companies, chaps 3, 6 (2d ed Cal CEB 2007).

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§2.33 d. Trusts and Estates

For a trust, the title company usually requires a certified copy of the trust agreement. A trust certificate may also be used to establish the existence of the trust. Prob C §18100.5. A successor trustee may be required to provide additional proof of authorization to act, *e.g.,* an abstract of trust or an affidavit of change of trustee. Prob C §§18105-18108. On the purchase and sale of real property held in trust, see California Trust Administration §§5.47-5.62 (2d ed Cal CEB 2001); California Real Property Sales Transactions §§4.19-4.20, 9.18 (4th ed Cal CEB 2007).

For an estate, the title company requires a certified copy of the court order approving the sale and, if the Independent Administration of Estates Act applies (Prob C §§10400-12591), a copy of letters testamentary and evidence of compliance with Prob C §10580 (notice of proposed action). On an estate's authorization documents, see California Decedent Estate Practice §§18.78-18.80 (2d ed Cal CEB 2009).

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§2.34 e. Individuals

For an individual seller or borrower with a common name, the title company may require that party to complete a statement of identity or information that enables the title company to determine whether various liens have attached to the property. See also §4.19.

Marital status is also important to determine the authority of an individual seller to convey. Some (but not all) title companies require the spouse of a married seller or borrower to execute a quitclaim deed, even if title is held as the seller's or borrower's sole and separate property. The title companies that do not typically require quitclaim deeds probably will do so if they have actual or constructive notice of a pending divorce and a temporary restraining order prevents either party from encumbering or transferring any real property (community, quasi-community, or separate) without the other party's written consent or a court order. See Fam C §2040. Third parties who are unaware of the divorce action can rely on the state of record title. Fam C §2041.

If a spouse will not be available to execute a necessary deed or if an agent is appointed to act on behalf of a seller, a power of attorney will be needed. The power of attorney must be carefully drafted to authorize the particular acts to be undertaken by the agent. The title company may only accept the power of attorney if it has been signed and recorded within the last 6 months. For a more detailed discussion of powers of attorney, see California Law of Contracts §§2.46-2.68 (Cal CEB 2007).

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§2.35 2. Statutory Presumptions

Certain statutes create presumptions of authority, which can assist counsel in establishing the necessary authority. The Corporations Code deals with the presumptions created in favor of a bona fide purchaser by the recordation of a statement of partnership in the office of the county recorder where the general partnership owns real property. (For partnerships formed before January 1, 1997, effective until January 1, 1999, see former Corp C §15010.5; for partnerships formed after January 1, 1997, see Corp C §16105.) Corporations Code §15621(c)-(d) deals with bona fide purchaser presumptions created by recording a certificate of limited partnership in the office of the county recorder where the limited partnership owns real property. Likewise, Corp C §§313-314 create presumptions of authority for conveyances executed by certain corporate officers and methods to establish proof of the corporate proceedings that authorized such executions.

Limited liability companies are governed by Corp C §17050(c) (a certified copy of the articles of organization from the Secretary of State is conclusive evidence of the formation of the limited liability company) and Corp C §17154(c) (creating presumptions of authority for conveyances executed by certain officers of the company). For trusts, title companies usually accept a certification by the trustees regarding their authority because, under *Adler v Manor Healthcare Corp.* (1992) 7 CA4th 1110, 9 CR2d 732, bona fide purchasers or encumbrancers need not inquire about the trustee's authority. If there is a successor trustee, a title company will inquire about the trustee's authority to act.

PRACTICE TIP: Because of the high number of claims in this area, attorneys may find that some title companies are unwilling to rely on statutory presumptions, instead requiring proof of authorization to act as described in §§2.30-2.34.

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§2.36 J. Reviewing or Drafting Collateral Documents

The attorney should review any form documents prepared by the title company, including any subordination agreements necessary to the transaction and any indemnity agreements necessary for the underwriting of title. On subordination agreements, see California Real Property Sales Transactions §§9.66-9.99 (4th ed Cal CEB 2007). On indemnity agreements, see §§5.40-5.41.

The seller's attorney may need to assist in the creation of easements necessary or desirable for closing the transaction. On easements generally, see Real Property Sales §§11.43-11.77. If the seller intends to use a power of attorney to convey the property, the attorney should prepare and submit the power of attorney to the title company in recordable form early during the transaction for approval. On powers of attorney, see California Law of Contracts §§2.46-2.68 (Cal CEB 2007).

Although in some states an attorney's opinion of title is obtained in conjunction with the issuance of a title insurance policy, this practice is not followed in California.

The attorney may be called on to draft or review numerous other legal documents associated with a transfer of property, including deeds. See Real Property Sales, chap 10.

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§2.37 K. Preparing Escrow Instructions

Commonly, buyer's and seller's attorneys either review escrow instructions that have been prepared by the title company or escrow company or prepare instructions on behalf of the client. Attorneys should pay close attention to the standard preprinted conditions in the title company's prepared forms for inappropriate indemnities or conditions allowing the escrow holder to release money or documents without the permission of both parties to the escrow. The buyer's instructions should set forth, among other things, what type of policy, coverage, and endorsements that the insurer must be prepared to issue before funds and deeds may be exchanged.

On title instructions, see §§10.13-10.17. On drafting escrow instructions generally, see California Real Property Sales Transactions §§15.31-15.47 (4th ed Cal CEB 2007). On buyer's escrow instructions, see Real Property Sales §§15.49-15.61. On seller's escrow instructions, see Real Property Sales §§15.62-15.73.

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Source: Real Property/California Title Insurance Practice/2 Advising Clients About Title Insurance/§2.38 L. Reviewing Title Insurance Policy

§2.38 L. Reviewing Title Insurance Policy

On receipt of the title insurance policy, the buyer's attorney should review it to confirm that the following information is correct and corresponds to the underlying documentation and the escrow instructions:

- Identity of the insured;
- Identity of the property;
- Date of the policy;
- Type of insurance (standard or extended coverage);
- Specific exceptions to coverage as approved by the buyer; and
- Order of recordation of any documents recorded at the close of escrow.

For further discussion of reviewing the title insurance policy, see §10.21.

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§2.39 M. Evaluating and Asserting Claims

For full discussion of theories of liability for claims that may be asserted against title companies, see chap 11. On the procedural aspects of filing claims, see chap 12. On litigating title insurance disputes, see chap 13.

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§2.40 III. ROLE OF ATTORNEYS IN LOAN TRANSACTIONS

If the borrower is simultaneously acquiring the property and obtaining a loan secured by a lien against the property, the borrower's attorney not only must undertake the tasks of the buyer's attorney but may also be called on to assist the borrower in the loan transaction. The borrower's attorney must take similar steps in the case of a refinancing. The lender's attorney will also need to assess title insurance coverage available to the lender.

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§2.41 A. Reviewing Exceptions to Coverage

The lender's primary interest in obtaining title insurance is to protect the priority and enforceability of its lien. To assist the lender, the attorney must first review the preliminary report to determine which exceptions to coverage should be eliminated. Exceptions that lenders typically find objectionable are documents securing existing financing and expired leases; easements and encroachments; and covenants, conditions, and restrictions that do not contain mortgagee protection language. See Forming California Common Interest Developments §6.86 (Cal CEB 2004). Usually, the lender's attorney informs the prospective borrower what coverage will be required at closing. On title insurance issues important to lenders, see chap 8.

The borrower's attorney may need to resolve issues related to exceptions to coverage. For example, the attorney may have to coordinate the payoff of an existing debt secured by the property, resolve issues regarding encroachments, or modify or remove an easement impairing access.

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B. Determining Appropriate Coverage

§2.42 1. Recommending Appropriate Policy

The attorney should help the lender determine which policy and endorsements to obtain. The attorney may have to explain the distinction between standard and extended coverage policies to noninstitutional lenders. On the distinctions between the policies, see §§6.53-6.54. Although the extended coverage policy is more expensive, it provides significantly better coverage.

PRACTICE TIP: All institutional lenders require an extended coverage lender's policy, and attorneys should encourage private lenders to seek this coverage as well. Sometimes, however, title companies refuse to underwrite extended coverage for individual lenders, even when a recent ALTA survey is available. Title companies decide whether to issue extended coverage policies to private lenders on a case-by-case basis. A title company should be willing to issue the coverage if the associated risks can be eliminated. For further discussion of the requirements for an ALTA survey, see §§2.18, 4.32.

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§2.43 2. Recommending Amount of Coverage

The attorney may advise on the amount of coverage for certain transactions. For instance, if a transaction involves a loan that permits negative amortization because of a variable interest-rate provision, the loan balance will increase rather than decrease over the life of the loan. In such a case, the amount of coverage obtained at close of escrow will be insufficient if a total loss occurs. An endorsement may be available to deal with the possible loss of priority or invalidity of the lien arising from changes in the interest rate. See §§8.61-8.62, 8.87-8.88, 8.99-8.100.

The lender may suffer adverse tax consequences from the taking of the encumbered property by eminent domain resulting in early payoff of the insured installment obligation. Therefore, the attorney must also carefully consider possible adverse events, such as bankruptcy and eminent domain proceedings, in recommending the proper title insurance coverage.

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§2.44 3. Recommending Endorsements

Endorsements to the policy are as important as the form of coverage. For discussion of the types of endorsements available to lenders, see chap 8. In addition to the standard CLTA endorsements, special title company endorsements are available. For examples of special endorsements, see §§8.50, 8.103-8.118.

Construction loans may present special mechanics' lien issues if work is started on the project before the loan is funded. In such a situation, any mechanics' lien subsequently recorded against the property takes priority over the construction loan. The lender's attorney should insist that the title company insure the priority of the lien of the construction loan whether or not work has started. To do so, the title company may require the borrower to provide it with an indemnity if construction has started. On indemnity agreements, see §5.41. On mechanics' lien endorsements, see §§8.83-8.84.

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§2.45 C. Drafting and Reviewing Documents

The borrower's attorney may review, comment on, and negotiate the loan documents. An attorney's opinion is frequently required in large transactions. See *1995 California Real Property Legal Opinion Report*, 13 Cal Real Prop J 1 (Fall 1995), which provides the standards for giving opinions.

PRACTICE TIP: In some situations, lenders accept an applicable endorsement in lieu of a legal opinion. Examples include endorsements regarding zoning and Subdivision Map Act compliance. See §§8.101, 8.93-8.94, respectively.

The attorney may be called on to draft numerous documents dealing with evidencing and securing the loan. Those documents are beyond the scope of this book. On drafting loan commitments, see California Real Estate Finance Practice: Strategies and Forms, chap 2 (Cal CEB 2000).

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§2.46 D. Confirming Authority to Borrow

If the loan is on property already owned by the borrower, the borrower's attorney must establish the borrower's existence and authority to act. See §§2.29-2.35.

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§2.47 E. Evaluating and Asserting Claims

For full discussion of theories of liability that may be asserted against title companies, see chap 11. On the procedural aspects of filing claims, see chap 12. On litigating title insurance disputes, see chap 13.

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§2.48 IV. ROLE OF ATTORNEYS IN LEASEHOLD TRANSACTIONS

A tenant of property who intends to (a) make substantial improvements to the leasehold, (b) sign a long term lease, or (c) take a substantial amount of space may want to obtain title insurance to assure itself that no senior lien can foreclose the leasehold interest. The steps to be taken are much the same as those for a buyer of property. See §§2.4-2.39. On leasehold owner's policy, see §§7.55-7.57. On leasehold lender's policy, see §8.39. On commercial leasing transactions generally, see Retail Leasing: Drafting and Negotiating the Lease (Cal CEB 2007); Office Leasing: Drafting and Negotiating the Lease (Cal CEB 1996).

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3

Selecting Title Insurer and Initiating Title Process

Alice L. Akawie
Rod Pasion

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§3.1 I. WHO SELECTS THE INSURER

Who selects the title insurer often depends on the type of transaction and the relative negotiating strength of the parties. In a purchase and sale transaction, the purchase agreement generally designates the insurer. Sometimes a seller insists on using a particular title company because it either offers advantageous pricing or is willing to write over a title defect. Title companies, however, are prohibited from offering rebates or kickbacks to induce sellers to place or refer title insurance business. Ins C §12404. See §1.13. The buyer may have opposing desires. As the prospective owner of the property, the buyer wants a solvent title insurer that is acceptable to the buyer's lender.

In transactions in which a loan will finance the purchase of a one-to-four-unit family structure, the Real Estate Settlement Procedures Act (RESPA) (12 USC §§2601-2617) prohibits the seller from requiring the buyer to use any particular title company. 12 USC §2608. For discussion of RESPA, see California Real Property Sales Transactions §15.95 (4th ed Cal CEB 2007) and §1.14.

In a lending transaction, the lender's commitment letter usually designates the insurer. The lender wants a financially stable insurer.

PRACTICE TIP: Regardless of who selects the title company, the insured's counsel should contact the title officer directly to discuss specifics of the transaction and confirm the type of coverage sought.

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II. TITLE INSURANCE COMPANIES AND UNDERWRITTEN TITLE COMPANIES

§3.2 A. Differences Between Title Insurance Companies and Underwritten Title Companies

The two primary types of title companies doing business in California are title insurance companies and underwritten title companies. (A third type of title company, an abstract company, is rare in California.) A title insurance company is an insurer specializing in real property ownership and liens. See §§1.2-1.3. An underwritten title company is the agent of the title insurance company. It countersigns and issues a title insurance company's policy of title insurance and performs related functions, such as doing a title search and issuing a preliminary report. See Ins C §12389; §§1.5, 1.10. Unlike a title insurance company, which may issue its own title insurance policy, an underwritten title company may not, because it is not an insurer.

PRACTICE TIP: An easy way to ascertain whether you are dealing with an underwritten title company is by its name. An underwritten title company will not have the word "insurance" in its name. Many local title companies (*i.e.,* at the county level) are underwritten agents of a national title insurance company.

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§3.3 1. Underwriting Agreement

The underwriting agreement between the title insurance company and the underwritten title company sets out their respective rights and liabilities. Typically, the agreement covers allocation of fees earned for the issuance of title policies, the responsibility for any sustained losses, standards to be met by the underwritten company before a policy can be issued, and other operational aspects of the relationship between the parties. The agreement must include a procedure "reasonably calculated to prevent the misappropriation, disappearance, or wrongful use of funds deposited into the underwritten title company's escrow or subescrow account." Ins C §12389.6(a).

If an underwritten title company is placed into bankruptcy, receivership, or conservatorship by the insurance commissioner, a title insurance company that is a party to an underwriting agreement with the underwritten title company will be liable for any shortages in escrow or subescrow accounts. Ins C §§12376-12377.

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§3.4 2. Distinctions in Liability

Attorneys who deal with underwritten title companies should be aware of the distinctions in liability between an underwritten title company and a title insurance company. The intent of the underwritten agreement is to create a limited agency, with the underwritten title company acting as an agent of the title insurance company for the purpose of issuing title policies.

The differences in liability were discussed in *Contini v Western Title Ins. Co.* (1974) 40 CA3d 536, 115 CR 257, which was decided before the Insurance Code was modified to clarify the liability of the issuer of the preliminary report. Although changes to the Insurance Code have eliminated the specific issue in *Contini,* the scope of the title insurance company's liability for acts of the underwritten title company remains an issue.

An abstractor's liability is generally limited in California. Ins C §§12340.10-12340.11. On abstractor's liability, see §§5.25, 11.38-11.41; on title company's liability, see §§5.20-5.27, chap 11.

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§3.5 B. Use of Closing Protection Letter If Underwritten Title Company Is Involved in Transaction

The insurer's liability applies only to the act of issuance of the policy and not to its agent's closing activities, such as handling documents, preserving funds, following instructions, or related issues. Whenever an underwritten title company is involved in a transaction, the attorney should consider using a closing protection letter. See App A for ALTA form of closing protection letter and explanation. This letter protects the parties from:

- Fraud or dishonesty of the closing agent;
- Failure of the closing agent to obtain a document necessary to the transaction (such as a deed, deed of reconveyance, or subordination agreement);
- Failure of the closing agent to follow written closing instructions relating to the status of title and the enforceability and priority of liens; and
- Failure of the closing agent to collect and/or pay out funds.

The closing protection letter excludes liability:

- If the instructions require insurance that is inconsistent with a commitment to insure;
- If funds are lost owing to a bank failure, unless the closing agent disregarded written instructions on choice of bank; and
- For mechanics' liens unless covered by the title policy.

Any party can insist on a closing protection letter, but a lender in particular should be cautious about wiring large sums of money to underwritten title companies unless it has obtained a closing protection letter. A closing protection letter is available only if insurance is issued in conjunction with the transaction and if the transaction is closed through an authorized agent or an approved attorney. (An approved attorney is not usually an agent of the title company but has authority to issue title opinions on which the title insurer can rely. The approved attorney generally is unable to issue a policy.) A closing protection letter usually is not available if the closing agent is an independent escrow or closing company.

A closing protection letter is not assignable. It is furnished without cost by the insurer and puts the insurer's financial strength behind that of the closing agent. It continues in force as long as there is no written cancellation. By issuing a closing protection letter to an insured, the insurer is generally precluded from claiming that the closing agent's misconduct was beyond the scope of the agent's authority. A closing protection letter is unnecessary if escrow is handled by a branch of a title insurance company. See *Ford v Guarantee Abstract & Title Co.* (Kan 1976) 553 P2d 254.

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§3.6 III. FACTORS TO CONSIDER IN SELECTING INSURER

Selecting a title insurer is an important decision, which should occur only after considering numerous factors, including the insurer's financial stability, the cost of the insurance, the insurer's flexibility in making underwriting decisions, the quality of the insurer's work, the type of services offered, and the accessibility of the insurer's decision makers.

Because of the widespread use of the American Land Title Association (ALTA) and California Land Title Association (CLTA) form policies, title companies compete less on products and more on service and price. Product may be a factor in some cases, however. For instance, a lender may seek a policy comparable to a form withdrawn by the ALTA. Some title companies make comparable forms available and others do not. See also §6.9.

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§3.7 A. Financial Stability

The prospective insured will be concerned about the financial stability of both the title insurance company and the underwritten title company. The insured relies on the title insurance company to be financially responsible for the priority and enforceability of liens and for the validity of title to real property, if the liens or title are not as represented in the title policy. Thus the title insurer's solvency and stability are key considerations. The insured relies on the underwritten title company to obtain the title policy from its underwriter and follow escrow instructions. Problems could arise if the underwritten title company becomes insolvent during a transaction while it is holding funds. On title insurance companies' liability for insolvent underwritten title companies, see §3.3.

PRACTICE TIP: Some excellent sources of information are available to customers researching the financial security of a particular title insurance company:

(1) Traditionally, the primary source was an annual financial statement, filed in accordance with statutory accounting principles, by all title insurers with their respective state insurance regulators on the National Association of Insurance Commissioners Form 9 statement. Because Form 9 statements constitute a standardized source of information, they are amenable to side-by-side comparisons. These forms can be obtained from title insurance companies on request and at no cost. Copies are also available from the Department of Insurance.

(2) More recently, partly as a result of title insurers' assisting in the transfer and securitization of mortgages, rating companies (*e.g.,* Standard & Poor's Rating Group, Duff Phelps Corporation, Demotech, Inc.) issue reports that assign claims-paying ability ratings to individual title insurance companies. The ratings are based on such factors as the company's market position in the industry, financial results over the last several years, adequacy of capitalization and reserves, and the quality of the company's investment portfolio. The primary source for financial information on underwritten title companies are the quarterly financial statements filed with the state insurance commission. Ins C §12389.4.

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1. Reinsurance

§3.8 a. Why Reinsurance Is Used

Although there is no limit to the size of title policies that might be requested, title insurers recognize that there is a limit to the size of any loss that each could manage to pay. To solve this problem, the insurer enters into reinsurance agreements with other title insurers. The result of this arrangement is the "laying off" or "spreading" of large liability policy risks with other companies.

In addition to the desire to spread the risk, three other factors require title insurance companies to reinsure risks. The most restrictive of the following factors controls whether reinsurance is necessary.

- First, the statutes of many states have specific maximum single-risk retention limits and similar limits on a title insurer's capacity to assume reinsurance. In general, these limitations are expressed as a percentage of various aggregates of capital, surplus, and reserves as set forth in the insurer's most recent Form 9 statement on file with the state insurance commission. Ins C §§12380-12388. See §3.7.
- Second, many large title insurance customers, especially life insurance companies and institutional lenders, impose maximum single-risk limits for title insurance companies. These limitations, based on review of the insurer's annual reports and information in the Form 9 statement, are generally prescribed as a percentage of estimated net worth of the particular insurer.
- Third, although title insurers have little or no control over the first two factors, each company limits the liability it can assume on both risk retention and reinsurance assumptions. These "in-house" limits vary widely, depending on each company's periodic evaluation of its assets and liabilities. Usually, the title insurer keeps its maximum dollar retention and obtains reinsurance for the balance.

PRACTICE TIP: Reinsurance may also be requested by the insured, even when not required by one of the foregoing factors. Most institutional lenders routinely require reinsurance for large transactions in order to spread the risk even if the title company does not require it. Whether the cost of all or a part of the reinsurance is passed on to the insured is settled on a case-by-case basis. If the named insured requests a written quote for policy coverage, this factor should be included in the request for quote. See §3.27.

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§3.9 b. How Reinsurance Works

The original title insurer, known as the ceding company or ceder, obtains insurance from another insurer, known as the reinsuring company, against loss on the ceding company's original policy. See Ins C §§620, 12380(b)-(c). The reinsuring company undertakes a portion of the ceding company's rights, obligations, and liabilities under the original policy, consistent with the portion of the loss it is assuming. *In re Mission Ins. Co.* (1995) 41 CA4th 828, 48 CR2d 209.

The ceding company retains a certain portion of the loss for which it remains primarily liable. Generally, the primary retention is $5 million and any remaining amounts that the ceding company retains above that amount become secondary reinsurance. The ceding company must pay a claim in the amount of the primary retention (first level) before the second company (or companies) pays (second level). There may also be a third level of reinsurance if the transaction is extremely large (*e.g.,* over $250 million). If more than one company reinsures the transaction, the companies issuing the reinsurance share losses pro rata, based on the relationship of the amount of reinsurance issued by the particular reinsurer and the total amount of reinsurance issued. If there is more than one level of reinsurance, the losses are shared pro rata at each level of reinsurance, and earlier levels must be exhausted before losses are shared at the next level.

In a few transactions, a fourth (quaternary) level of reinsurance is used and even fewer transactions have a fifth (quinary) level. There is nothing troublesome about these successive layers, other than making certain that the reinsurance accurately deals with the multilayered concept. ALTA has promulgated temporary forms for these levels of reinsurance.

Because the reinsuring company independently underwrites the transaction, the reinsuring company will not accept it until the ceding company submits the risks that are to be reinsured. The ceding company must completely disclose all risks to the proposed reinsurer, including unusual ones such as mechanics' liens, leveraged buyouts and other creditor's rights problems, and any special endorsements that may require special underwriting. Although the reinsuring company remains liable to the insured if any risk is not disclosed, it would have a claim against the ceding company for the ceding company's failure to disclose. In addition, the reinsurer may adjust the cost of the reinsurance because of special risks.

Similarly, if any company declines to reinsure, the ceding company must resubmit the reinsurance to any companies that have already accepted it, advise them that a company has declined a portion of the risk, and explain why. A reinsurer who previously agreed to provide reinsurance may then withdraw. This procedure prevents the previously accepting companies from claiming that the ceding company failed to disclose all information.

All reinsurers and the ceding company must consent to any modifications of the reinsurance. It is therefore necessary to allow enough time between the issuance of the reports and the actual closing of the transaction to permit this review of the risks and the structuring of the reinsurance. Occasionally, the reinsurer will retrocede a particular risk back to the primary company, which found the risk acceptable. Retrocession can facilitate the reinsurance process because a reinsurer may continue to participate in some risks in the transaction while retroceding others back to the ceding company.

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Source: Real Property/California Title Insurance Practice/3 Selecting Title Insurer and Initiating Title Process/§3.10 c. How Insured Obtains Direct Access to Reinsurer

§3.10 c. How Insured Obtains Direct Access to Reinsurer

Although the insured generally has no interest in the reinsurance contract (see Ins C §623; *Prudential Reins. Co. v Superior Court* (1992) 3 C4th 1118, 14 CR2d 749), the insured does have direct access to the reinsurer through the 1994 ALTA facultative reinsurance agreement. The ALTA reinsurance forms are called "facultative" agreements, which means that the basic terms of the reinsurance contract are set forth in the preprinted language, while specific information about the particular policy and the names of the ceding company and reinsurers and the amounts they retained are in an attached schedule. The insured under the policy is not a party to the reinsurance agreement and thus has no enforceable rights under that agreement unless it expressly grants such rights.

The first reinsurance agreement in general use (the 1961 ALTA Facultative Reinsurance Agreement) provided limited direct access rights. In effect, the insured could proceed directly against the reinsurers only if the ceding company was insolvent, had ceased doing business, or had failed to honor its policy obligations. Because insureds found this system unsatisfactory, separate agreements between the insured and each reinsurer (with the ceding company's consent) arose, granting the insured the right to enforce the reinsurance agreement directly against each reinsurer (*i.e.,* direct access). In 1985, the ALTA promulgated its first form of reinsurance agreement that incorporated direct access as one of its regular provisions.

The current form (the 1994 ALTA Facultative Reinsurance Agreement) continues to include a direct access provision permitting the insured to sue the reinsurer directly if the insured is also suing the ceding company and if the loss exceeds the initial retention held by that company. It also allows the reinsuring company to pay claims directly to the insured rather than to the ceding company. Paragraph 3 of the 1994 ALTA Facultative Reinsurance Agreement.

PRACTICE TIP: Because the ALTA Facultative Reinsurance Agreement provides direct access, it is present in every reinsured owner's or lender's reinsurance agreement. Counsel may seek a copy of the agreement, which will identify the reinsurers. Institutional clients have frequently established requirements on reinsurance (and coinsurance). Attorneys representing these clients should be aware of these requirements.

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2. Coinsurance

§3.11 a. What Is Coinsurance

Coinsurance is another mechanism for spreading risk, though it is not as common in California as is reinsurance. Coinsurance exists when two or more separate insurers issue policies on the same title to the same person. For coinsurance to exist, "the insurable interest contemplated by both policies [must be] identical, *i.e.,* coverage by different insurers of the same insured and the same risk." *Ohio Cas. Ins. Co. v Harbor Ins. Co.* (1968) 259 CA2d 207, 213, 66 CR 340. See also Ins C §590.

PRACTICE TIP: Many attorneys and lenders explain their preference for coinsurance by reasoning that coinsurance will provide more than one title search, which they believe decreases the risk of a problem. Although this is sometimes true, it is more likely that companies will rely on the same title search or that the same title plant will perform all the different searches. (See chap 4 for discussion of the title search process.) The proposed insured may avoid this by insisting on separate searches before the title companies share their information. Another reason given for coinsurance is the existence of direct access to all companies; but a direct access agreement can give the insured the same rights that a coinsured policy would. (See §3.10 for further discussion of direct access agreements.) Coinsurance may also be selected as a way to reduce the insured's risk if one insurer becomes insolvent.

As with reinsurance, the coinsuring companies need to coordinate the issuance of their policies and assign the role of lead company to one of the insurers. Issues may arise between the companies as to who is leading the transaction. If the insured designates a particular coinsurer to coordinate the processing of information and documentation involved in the transaction, that company is the "lead coinsurer."

PRACTICE TIP: To avoid confusion and duplication of work, the attorney should communicate with each coinsurer on its respective role in the transaction.

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b. Forms of Coinsurance

§3.12 (1) Straight or First Dollar Coinsurance

In the most common form of coinsurance, referred to as "straight" or "first dollar" coinsurance, two or more title insurers issue their own policies for the same insured, covering the same interest, with each coinsurer assuming a designated portion of liability for both total risk and partial losses. The respective liabilities may be equal or proportionate. If a loss occurs, the insured must proceed against each coinsurer to recover the appropriate share of losses, rather than pressing all claims through one insurer as if only reinsurance had been issued. Under this form, each policy includes a coinsurance clause substantially as follows:

> This policy is issued contemporaneously with a $[amount] policy of [Blank] Title Insurance Company [and a $[amount] policy of [Blank] Title Insurance Company (etc., until all remaining Coinsurers and their respective policy amounts are listed)], all such contemporaneously issued policies totaling $[aggregate amount of all policies], and it is understood and agreed that, for all loss or aggregate losses against which these policies protect, the Company shall bear only [fraction] of any such loss, and in no event shall the Company be liable for loss in excess of the face amount of this policy.

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§3.13 (2) Excess Coinsurance

In rare cases, "excess coinsurance" is used. When it is, the coinsurance provisions will not take effect until after the lead coinsurer has paid claims aggregating a specific amount. This form was more prevalent before direct access was universally accepted by all title insurers. As with straight coinsurance, the lead coinsurer and the excess coinsurers use excess coinsurance clauses substantially as follows:

Lead Coinsurer's Version

This policy is issued contemporaneously with a $[amount] policy of [Blank] Title Insurance Company [and a $[amount] policy of [Blank] Title Insurance Company (*etc.,* until all remaining Coinsurers and their respective policy amounts are listed)], all such contemporaneously issued policies totaling $[aggregate amount of all policies], and it is understood and agreed that, for all loss or aggregate of losses against which these policies protect up to and including $[primary amount], the Company shall bear only [fraction] of any such loss, and in no event shall the Company be liable for loss in excess of the face amount of this policy.

Excess Coinsurer's Version

This policy is issued contemporaneously with a $[amount] policy of [Blank] Title Insurance Company [and a $[amount] policy of [Blank] Title Insurance Company (etc., until all remaining Coinsurers and their respective policy amounts are listed)], all such contemporaneously issued policies totaling $[aggregate amount of all policies], and it is understood and agreed that the Company does not assume any liability under this policy unless and until the loss or aggregate of losses against which these policies protect shall exceed $[primary amount], and in no event shall the Company be liable for loss in excess of the face amount of this policy.

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Source: Real Property/California Title Insurance Practice/3 Selecting Title Insurer and Initiating Title Process/§3.14 (3) Joint and Several Coinsurance

§3.14 (3) Joint and Several Coinsurance

A final variety of coinsurance called "joint and several" allows the insured to press its claim against any one of the several coinsurers for losses up to $1 million. The chosen coinsurer would pay such covered loss without immediate contribution from any other coinsurer. The following is an example of a joint and several clause for a $15 million deed of trust equally coinsured with two other title companies:

> This policy is issued contemporaneously with a $5,000,000 policy of [FIRST] Title Insurance Company and a $5,000,000 policy of [SECOND] Title Insurance Company, the three policies to be in the aggregate amount of $15,000,000, and it is understood that the Company shall bear only one-third of any loss or damage insured against by these policies; provided, however, that the Company shall be liable jointly and severally with [FIRST] Title Insurance Company and [SECOND] Title Insurance Company for the first $1,000,000 of loss or damage insured against by these policies and incurred by the Insured under these policies, but in the event of loss or damage incurred by the Insured aggregating in excess of $1,000,000, the Company shall have no liability in excess of the greater of: (i) $1,000,000; or (ii) one-third of such aggregate loss or damage, and in no event shall the Company be liable for contractual damages of more than $5,000,000 plus costs, attorneys' fees and expenses that the Company may become obligated to pay under this policy.

In each situation in §§3.12-3.14, if any one or more of the coinsurers issues a policy in excess of its retention limit (whether self-imposed, imposed by statute, or imposed by the customer), the coinsurance policies must also be reinsured. See §§3.8-3.10.

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B. Premiums

§3.15 1. Regulation of Pricing Practices

Although title insurance policy rates are not set by statute or regulation, pricing practices are regulated. The general standards for setting and using premium rates are set out in Ins C §12401.3. Rates may be neither excessive or inadequate nor unfairly discriminatory. Rates must allow for the probability of loss on the various risks insured, as well as for profits, contingencies, prospective expenses, and other factors that the title insurer deems important. For rate-making purposes, risks and services may be classified by the size of the insured transactions, expenses involved, geographic location of transactions, individual experience of the title insurer, and any other reasonable considerations. To the extent that insurers establish classifications, they must apply equally to all risks covered within each classification under the same or substantially the same circumstances or conditions.

Title insurers must file rate schedules with the Insurance Commissioner, stating the charge to the public for each type of title policy and for escrow services. They must also specify the portion of any charge based on work performed by an underwritten title company. Ins C §12401.1. An enormous flexibility in rates arises from the peculiarities of the filed-rate structure. A transaction might qualify for a special pricing package, including short-term rates, binders, special project rates, revamp rates, or rewrite and reissue rates. See §§3.18-3.26 for further discussion of these special pricing items.

The Real Estate Settlement Procedures Act (RESPA) (12 USC §§2601-2617) also regulates title insurers' ability to provide free services in transactions involving the sale or financing of one to four residential units On RESPA, see California Real Property Sales Transactions §15.95 (4th ed Cal CEB 2007) and §1.14. Under Ins C §12404.1, title companies must charge the rate stated in their rate filings for all services rendered. They must also make reasonable efforts to collect these charges, but they may waive the charges if the company makes it a practice to do so for all customers in like circumstances when a transaction is not consummated. This approach allows the title company to waive charges for a preliminary report when an escrow does not close. A title company may also waive its charges when the preliminary report contains an exception to coverage that the company declines to remove from its policy, and another company is willing to remove the exception or provide affirmative coverage against loss from the exception.

When no escrow is opened, a title company can furnish a property profile, without charge, containing the name of the owner of record and the legal description of the property. The information in a property profile is considerably less useful than that in a preliminary report. It will show real property tax and assessment information and include a copy of the latest deed and deed of trust.

See §1.8 for information on the brochure provided by the Insurance Commissioner for residential real estate title insurance consumers.

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§3.16 2. Factors in Setting Premiums

The premium amount charged for a title insurance policy depends on several factors. Title insurance premiums are established to cover costs of maintaining the title plant, conducting the title search, administering claims against insurance coverage, and providing a reasonable profit. Sometimes a separate charge is collected for the preliminary report if the transaction requires a difficult or time-consuming search or presents unusual or complex issues involving extraordinary underwriting issues. The premium amount increases in proportion to the liability assumed, which is the face amount of the policy. The various rate schedules have a sliding scale, with the last dollar of coverage being the least expensive.

The face amount of the policy for the owner's insurance is usually equal to the purchase price or the fair market value of the property.

PRACTICE TIP: The face amount of an owner's policy may be increased beyond the purchase price on presentation of convincing evidence that the property has a greater value or that the owner spent additional funds to improve it. Generally, such an increase is made after the investment of the additional money and is accomplished by adding CLTA endorsement 107.2 to the policy. See §§7.86-7.87. The insurer may require an appraisal or other evidence of the increase before issuing an endorsement.

Typically, the face amount of the lender's insurance is the original principal amount of the loan. Occasionally, this amount may be higher, if the lender wishes to increase the amount because of negative amortization features (see §§8.99-8.100 on CLTA 111.8 endorsement), or lower, if the lender has allocated a portion of the loan proceeds to security other than the land insured under the policy (see §§8.108-8.109 on last-dollar endorsement).

The premium may increase because of extra work charges in certain circumstances, *e.g.,* if (a) the insured property contains more than one adjoining but legally separate parcel, (b) the insured property is located in more than one county (c) multiple noncontiguous sites are involved, or (d) the transaction changes significantly after the initial search has been performed.

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§3.17 3. Endorsements

In addition to the premiums for the base policy, title insurers charge for endorsements to policies. Some endorsements are available with the policy at no extra charge—most notably the 100 and 116 endorsements, which accompany an ALTA lender's policy. The charges for other endorsements vary widely, depending primarily on the risk being assumed by the title insurer and the cost associated with underwriting the issuance of the endorsement. See chaps 7-8 for further discussion of endorsements.

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Source: Real Property/California Title Insurance Practice/3 Selecting Title Insurer and Initiating Title Process/§3.18 4. Methods of Reducing Premiums

§3.18 4. Methods of Reducing Premiums

In addition to shopping with different title insurers for a favorable premium on the proposed policy, other mechanisms available to the insured to save money include:

- Short-term rate premiums (see §3.19),
- Binders (see §§3.20-3.22),
- Special rates (see §§3.23-3.25), and
- Credits for existing insurance (see §3.26).

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§3.19 a. Short-Term Rate Premiums

Short-term rate premiums are available when a party obtains a new policy on property for which a policy was issued within the last five years. Although availability of the short-term rate depends on the terms of the rate schedule filed with the Insurance Commissioner by the individual insurer, as a matter of practice the short-term rate will be applied regardless of who issued the original policy. The premium will generally be 20 percent below the regular amount charged for a policy.

PRACTICE TIP: To take advantage of these rates, attorneys representing buyers and sellers should ascertain the last date that title insurance was issued.

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b. Binders

§3.20 (1) Definition and Coverage of Binders

A binder is a temporary contract of insurance in which the title insurance company agrees to issue a specified policy within a certain period of time. The standard CLTA binder form, Interim Binder Form A (see App B), contains an agreement by the title insurance company to issue a policy of title insurance within a stated period (generally two years) after the execution, delivery, and recordation of a valid and sufficient instrument conveying an insurable interest, estate, or lien to the proposed insured. Vesting of title, the nature of the estate or interest to be insured, a description of the land, and any exceptions to coverage are stated in Schedule A, which is attached to the binder. It is important to note that binders do not cover any defects, liens, or encumbrances affecting title that intervene between the date of the binder and the date of the conveyance to the proposed insured.

PRACTICE TIP: Buyer's counsel should recognize that the binder is not an abstract of title (see §5.25) but only a statement of the terms and conditions on which the insurer is willing to issue a title insurance policy if the offer to issue the binder is accepted. See Ins C §12340.11.

Between issuance of the binder and issuance of the policy, the purchaser of the binder holds the right to obtain title insurance coverage with specific exceptions already defined. The binder's coverage is limited by the policy that will be issued. Accordingly, the party ordering the binder must confirm the terms and conditions that the policy will contain when it is issued. Although there are no insuring clauses in the binder, the policy that is anticipated to be issued applies from the effective date of the binder. See *Metropolitan Title Guar. Co. v Gildenhorn* (DC Cir 1957) 249 F2d 933, 935 n5.

If any condition of the binder is not met (*e.g.,* failure to provide the title company with a legally sufficient deed showing title to be vested in the proposed insured), the company has no liability to the insured. The retention by the insurer of the premium paid for the binder does not constitute a waiver or estoppel that would preclude the insurer's asserting failure to comply with the conditions precedent set forth in the binder as a defense to a claim. *Glass v Stewart Title Guar. Co.* (Ga Ct App 1987) 354 SE2d 187, 189.

Buyers who intend to finance the construction of improvements at a later date or quickly resell or refinance the property often purchase binders because of the potential of significant cost savings on premiums. See §§3.21-3.22.

For further discussion of binders, see Burke, Law of Title Insurance (3d ed 2000).

PRACTICE TIP: If a potential claim arises before the holder of the binder exercises its right to obtain a policy under the binder on resale or refinance, the holder should ask the title company to issue the policy so that the holder can tender a claim. If the holder makes a claim without requesting issuance of the policy, some title companies will treat the claim as tantamount to a request to issue the policy, and insurance is then present to support the claim. See chap 11 for discussion of potential claims under title policies.

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§3.21 (2) Using Binders in Resale Transactions

Normally, a binder is obtained by a purchaser who intends to resell the property within the time period specified in the binder. A binder gives its holder the right to obtain coverage during the holding period, resell the property, and provide title insurance for the new owner at a cost only slightly greater than that of a single owner's policy (generally 110 percent of the premium for a single owner's policy in the same amount).

EXAMPLE: Josie obtains a two-year binder on property she purchased from the seller, intending to quickly resell the property. Within two years, she resells to Hiram. Under customary practice of the county in which Josie lives, the seller pays the title insurance premium. By opting for a binder (rather than just a policy) at the time of her purchase, instead of paying 100 percent of the cost of two different policies (her own and Hiram's policy), she pays only 110 percent of the cost of one policy for the binder, which will protect her by giving her the option to become the insured during the first two years, and, if she does not exercise her option, will provide a title policy to Hiram on the resale.

Purchasing a binder is even cheaper than obtaining a short-term rate. See §3.19. However, the owner must either resell the property within the period of time specified in the binder or lose the 10 percent in premium dollars that it paid for the binder.

If the holder of the binder does not accept the title company's offer to issue the policy within the binder period, the binder lapses by its terms. Some title companies will issue a policy to the party purchasing the binder if it is not resold within the period of the binder; others allow the binder to lapse. Although not obligated to do so, most title companies will extend the binder for additional periods of one year each on payment of an additional premium (*e.g.,* 10 percent of the single policy cost for each extension).

PRACTICE TIP: It is important for an attorney advising the buyer of a binder to ascertain the title company's policy in this regard and to be sure the client understands the risks. Thus, binders are appropriate only when immediate or near-term resale of the property is planned. The buyer's attorney should advise the client to calendar a date between 30 to 60 days before the end of the binder period so that, if the client does not or can not resell, the client can take action to make sure that coverage does not lapse (*e.g.,* by obtaining an extension or having the policy issued in the client's own name). If the client anticipates needing an option to extend (*e.g.,* it intends to do extensive repairs, which may take some time before reselling), the client should negotiate for a right to extend to be included in the binder itself.

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§3.22 (3) Using Binders in Refinancing Transactions

Binders can also be used to reduce premiums when refinancing. For example, when a client purchases property by using seller financing by (a) assuming the seller's loan, which is due shortly in order to avoid a prepayment penalty, (b) using a short-term bridge loan, or (c) using its own funds with the intent to refinance the property within a relatively short period (*e.g.,* two years), it can purchase a binder for 110 percent of the single policy premium fee at the time of purchase to cover the subsequent refinancing. The binder does not entitle the buyer to a refund, but it does entitles the buyer to receive a substantial discount on the later issuance of the refinancing lender's title insurance policy, the cost of which the refinancing borrower would have to pay.

EXAMPLE: Title companies usually give the owner a "simultaneous issue" or "concurrent" discount rate for a lender's policy when, at the time of acquisition, an owner buys an owner's policy and pays for the lender's policy. By purchasing a binder, an owner who refinances within the binder period can request that the owner's policy be issued at the same time as the refinancing loan to qualify for the simultaneous discount rate for the lender's policy, even if the owner acquired the property earlier (*e.g.,* two years before).

As noted in §3.21, the refinancing binder can also usually be extended for additional one-year periods for an additional premium.

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Source: Real Property/California Title Insurance Practice/3 Selecting Title Insurer and Initiating Title Process/ c. Special Rates/§3.23 (1) Planned Project or Special Project Rates

c. Special Rates

§3.23 (1) Planned Project or Special Project Rates

"Planned project" or "special project" rates are used to price major commercial, industrial, or apartment developments involving the issuance of policies either together or at a different times in an aggregate liability of at least $5 million.

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§3.24 (2) Revamp Rates

"Revamp" rates are used to cover a new loan given for the sole purpose of revamping or replacing a loan on substantially the same property, as long as the remaining unpaid loan balance is at least 50 percent of the original principal amount of the loan.

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§3.25 (3) Reissue and Rewrite Rates

"Reissue" and "rewrite" rates afford varying degrees of savings, depending on the transaction. A reissue rate applies to an insured owner who requests that (a) a current policy be reissued to date it down to the present time, or (b) a current CLTA policy be reissued as an ALTA extended policy.

Construction lenders qualify for a reissue rate when the previously issued loan policy is dated down and reissued after completion of construction. A permanent lender who replaces the construction lender qualifies for the rewrite rate.

CAVEAT: The description of special rates in §§3.23-3.25 are generic. Each title company may impose additional or different requirements for the desired rate. Counsel should discuss the proposed transaction with the title officer, who will be able to advise on the lowest rates available and specific conditions that must be met for each rate.

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§3.26 d. Credits for Existing Insurance

If an interest in real property is an underlying asset in a stock transaction or if there is a corporate merger or a change in the form of entity (for example, a limited partnership converting to a limited liability company), then the buyer may desire new or updated title insurance on the underlying asset. The insured may be able to get new insurance from the current insurance company with full or partial credit for the existing insurance. The amount of the credit may depend on the amount of consideration paid in the current transaction or on the percentage interest retained by the original insured in the new entity.

PRACTICE TIP: If the change in ownership is one of form rather than substance, the attorney should consider obtaining a CLTA 107.9 endorsement, which simply adds the new entity as a named insured. See §§7.92-7.93. This approach may be less costly than obtaining a new title insurance policy. Because many REITs (real estate investment trusts) purchase partnership interests rather than underlying real estate interests, it is becoming common to obtain a date down of an existing policy together with a special endorsement, which insures that coverage will not be denied on the basis of the withdrawal or addition of a partner.

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Source: Real Property/California Title Insurance Practice/3 Selecting Title Insurer and Initiating Title Process/§3.27 5. Quotes

§3.27 5. Quotes

The attorney should obtain a written quote from the title company, detailing the specific charges for a policy and any desired endorsements, escrow and coordination services, special work charges, reinsurance costs, and an estimate of recording fees and transfer tax. The written quote is especially important in complex, high-risk transactions. To the extent that the attorney has solicited bids from a variety of insurers, the written quote is invaluable in comparing and contrasting each insurer's offer.

PRACTICE TIP: When soliciting written quotes, the solicitation should contain a complete description of the transaction and describe the type of coverage sought, including specific endorsements, any coinsurance and reinsurance requirements, and services needed in order to ensure that the quotes received are comparable.

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§3.28 C. Flexibility in Making Underwriting Decisions

A crucial consideration in selecting a title insurer is its flexibility in making underwriting decisions. If a title company refuses to issue a policy because it is unwilling to assume certain risks, the entire transaction can fail. Although a prospective seller or lender can discover whether another title company will underwrite the risk differently, time is often insufficient to shop for a new title insurer once the transaction is under way. Attorneys should make sure that the title insurer follows through and checks all its closing requirements in a timely manner.

In a complex transaction, it is a good idea to involve the title company's underwriter, whose approval is needed to issue the policy in a timely fashion. The underwriter may be able to suggest ways to structure the transaction to allow the title insurance to issue, because if problems arise the day before close of escrow (and it is not always possible to avoid this), the seller or the borrower has little time to negotiate a resolution. Finding a new title insurer at this juncture is seldom practicable.

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IV. INITIATING TITLE INSURANCE PROCESS

§3.29 A. Northern California

In Northern California, title and escrow are generally unified. The process of obtaining title insurance is commonly handled by opening escrow directly with the title insurer. (Although there are independent escrow agents in Northern California, they are not used as frequently as in Southern California.) It is possible to have a "title only" order if no escrow services will be required.

Once escrow is opened, the title company orders a preliminary report on the property that is the subject of the transaction. Even when escrow is not involved, the process is still initiated by ordering a preliminary report. If no title policy will be issued, it is no longer possible to obtain a preliminary report. Instead, insurers provide a property profile that supplies limited information about the property. See §3.15 for further discussion of property profiles.

In lieu of a property profile, an attorney can order a condition of title report or a recorded document guaranty. The condition of title report states how title is vested, lists current liens and encumbrances (with liability not to exceed $5000), and is available when no title policy is requested. It is useful to assist an attorney who is considering whether to commence or settle litigation or who is evaluating an opposing party's assets. The recorded document guaranty shows all requested recorded documents in the chain of title and may reveal prior uses of the property (*i.e.,* gas station leases). Thus, it is useful for an attorney who is (1) involved in due diligence to ascertain whether any liens have been filed under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) (42 USC §9607(*l*)(3)) or (2) considering commencing a quiet title action. See §§9.16-9.17.

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§3.30 B. Southern California

In Southern California, it is still common practice to use an escrow agent that is not a title insurance company. Most independent escrow agents have smaller financial resources than do title insurers because their tangible net worth requirement is substantially smaller. Compare Fin C §17210, governing escrow agents, with Ins C §12359, governing title insurers. Therefore, when an independent escrow agent is used, a party who is depositing funds to or receiving funds from the escrow should consider establishing, with the title insurer, a subescrow for the funds in order to gain the insurer's financial strength. Although the title company charges an additional fee for the subescrow, the fee may be more than offset by the increased fiscal responsibility of the entity holding the funds. While the subescrow handles the funds, the escrow agent continues to respond to instructions and handle the closing statements and all other documents. See also §§1.11-1.12, 10.3.

PRACTICE TIP: Most lenders insist that the title company handle funds through a subescrow. Most title companies insist on their handling payoffs of existing deeds of trust so that, if the lender fails to reconvey, the title company can prepare and record a release of obligation as a way to reconvey the deed of trust. See CC §2941(b)(3).

The independent escrow agent generally orders the title insurance coverage from the title company. This procedure makes the title company heavily, if not entirely, dependent on the escrow agent to provide the information needed to issue the title policy. This division of responsibilities between the escrow company and the title company increases the potential for error. As a result, the trend in large commercial transactions is to follow the Northern California practice, and obtain both escrow and title services from the title company.

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§3.31 C. Multistate Transactions

When a transaction involves property in more than one state, a single insurer should be selected to coordinate the entire transaction. Many title insurance companies underwrite throughout the country, while depending on title searches from local companies. This process can save time and provides a single source of coverage. Moreover, a single insurer can eliminate many of the complications that would otherwise exist when multiple states are involved, by issuing its policy as a "piggy back" on another insurer's policy. Thus, the insured receives coverage from a single company rather than several policies from a series of companies, which facilitates making a claim if it becomes necessary. On filing claims, see chap 12.

PRACTICE TIP: The national office of the title insurance company usually has departments that specialize in coordinating interstate transactions. An attorney involved in a multistate transaction should consider associating counsel licensed to practice in the other states involved in the transaction if the contract is governed by another state's law. Even if the contract is governed by California law, out-of-state counsel should be associated to draft or review deeds and other recordable instruments to make sure that they are enforceable and that they give appropriate notice.

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4

Title Search and Surveys

Marjorie Floyd Burchett

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I. SEARCHING TITLES

§4.1 A. Public Title Records Maintained in California

Because coverage under standard title policies is based largely on the content of "public records," the title insurer must search the appropriate records before issuing a policy. The term "public records" as used in most standard forms of policies, reports, and guaranties is usually limited by policy provisions to "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 without knowledge." See §4.7 on constructive notice, and §4.8 on documents that, although recorded in the public records, do not impart constructive notice. As discussed in §4.10, the title insurer usually does not actually search the public records but compiles the information in the public records into a more convenient and accessible form in its own privately owned database, commonly referred to as a "title plant," and searches that plant rather than the public records themselves. Although most metropolitan areas are serviced by title plants, in some areas of the state the insurer may search the public records directly.

The primary source of public title records in California is the office of the county recorder for the county in which the subject real property is located. State law mandates which instruments may be recorded in the public records (Govt C §27280(a)), as well as which recorded documents impart constructive notice. See 3 Miller & Starr, California Real Estate §§8:4-8:5 (3d ed 2000) for a list of those documents. See §4.8 for discussion of constructive notice.

Although original documents are presented for recordation in paper form, and documents are returned to the party recording them, Govt C §27279(b) authorizes county recorders to accept for recording, in lieu of the written paper, digitized images of recordable instruments if the image conforms to all other applicable statutes that prescribe recordability, except for the requirement for original signatures, and if the documents are submitted by federal, state, or local agencies. Government Code §27279.1 permits the recorders of San Bernardino County and Orange County to accept digitized images of a recordable instrument for recording, in lieu of a paper document, if:

- The requester and addressee for delivery of the recorded image is either a government agency described in Govt C §27279.2 or a licensed title insurer or underwritten title company described in Govt C §27279.3(a); and
- The county recorders of these counties determines that accepting electronically recorded documents from the requester is in the best interests of the county and the public, taking into account such factors as whether the volume and quality of the instruments submitted by the requestor are sufficient to justify electronic recordation and whether effective security measures for fraud and forgery can be put in place.

Government Code §27279.3 permits licensed title insurers and licensed underwritten title companies to record digitized instruments through January 1, 2000. After January 1, 2000, it permits anyone to record digitized instruments if the County Recorders of San Bernardino and Orange Counties makes certain findings set forth in Govt C §27279.1(a)(2). Government Code §27279.4 provides for the California Attorney General to appoint an Electronic Recordation Task Force to determine which persons and entities should be authorized to digitize and record documents electronically after January 1, 2000, "in order to limit real property fraud, forgery, and consumer risks associated with electronic recordation and provide a cost benefit to the county." The Task Force is also to establish guidelines for standardization of computer software and hardware to ensure maximum efficiency, cost-effectiveness, and maximum use of electronic recordation, as well as to determine appropriate recording fees to cover increased costs of electronic recordation.

Sections 4.2-4.6 describe the public title records maintained in California, from which the title companies obtain information to create their "title plants," discussed in §4.10.

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§4.2 1. County Grantor/Grantee Indexes

The most common method of indexing copies of documents recorded with the county recorder is a chronological listing of the documents into bound volumes or microfilm systems, which are indexed by the names of the grantors and grantees. Govt C §27257. Another, less common, system is to index records in separate bound volumes by document type (*e.g.,* deeds, mortgages, leases). Govt C §§27232-27256.

Both kinds of records are organized by grantors' and grantees' names, not by parcel numbers of land. Also, especially in populous counties, each volume of the index refers only to documents recorded over a one- or two-year period. Consequently, a multitude of volumes must be checked to conduct a complete search of the public records. As discussed in §§4.7-4.8, only certain recorded documents impart constructive notice. Many do not. Improperly indexed documents (*e.g.,* because of a misspelled name) may not give notice of a person's interest in the property (see §§4.23-4.24).

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Source: Real Property/California Title Insurance Practice/4 Title Search and Surveys/§4.3 2. State and Federal Judicial Records

§4.3 2. State and Federal Judicial Records

To provide constructive notice of pending cases or judgments affecting title to real property, a statutorily permitted and properly prepared notice of the action or judgment must be recorded in the records of the applicable county recorder. These include:

- Notices of bankruptcy adjudication (11 USC §549);
- Notices of conservatorship (Prob C §1875);
- Abstracts of judgment (CCP §697.310); and
- Notices of lis pendens (CCP §405.20).

The effect of the insured's actual knowledge of such cases should also be considered if bona fide purchaser or encumbrancer status is at issue, or for its impact on title insurance that excludes coverage for certain matters known to the insured. See §4.9.

NOTE: Code of Civil Procedure §405.20 has been amended to state that a notice of lis pendens *may* be recorded in the office of the recorder of each county in which all or part of the real property is situated. However, the notice of lis pendens *must* be recorded to provide constructive notice of its existence. CCP §405.24.

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§4.4 3. Property Tax Records

The county tax collector maintains records of the assessment of real property taxes levied by the county tax assessor, based on assessors' parcel numbers assigned to each nonexempt parcel of real property within the county. See Rev & T C §§50-54. The effect of supplemental taxes, which are levied by the county assessor based on intervening changes in assessed valuation (such as changes in ownership or property improvements occurring after the last property lien date), are reflected in the supplemental tax roll as provided in Rev & T C §75.11. Under Rev & T C §75.54(c), these assessments will not apply to purchasers taking title before the mailing date of the notice of a supplemental tax lien; those supplemental assessments will be personal obligations of the prior owner and will be entered on the unsecured tax rolls. See Rev & T C §75.11 for statutes of limitations on supplemental assessments. See §6.51 for discussion of the general property tax and assessment exception to coverage.

Special taxes levied under the Mello-Roos Community Facilities Act of 1982 (Govt C §§53311-53317.5) are collected by the county tax collector under Govt C §53340(e) "in the same manner as ordinary ad valorem property taxes" unless another procedure has been authorized. Notices of the special tax liens are recorded after the formation of a community facilities district in the records of the county recorder under Str & H C §§3114.5-3115.5. Because the special taxes levied in connection with those liens are not fixed at the time of recordation of the notice of special tax lien, but nonetheless have priority as of that date (Govt C §53340(e)), the rate and method of apportionment adopted for the district stated in the notice must be reviewed.

In recent years, as part of local governments' continuing efforts to generate revenues, certain municipalities have taken the view that their liens for unpaid water or utility bills are entitled to the same super priority lien status as other ad valorem real property taxes and assessments. The legislature rejected that viewpoint in enacting Govt C §43008, which provides that a lien on real property resulting from a delinquency in payment of rates or charges or the collection of future rates or charges, whether or not added to the tax assessment rolls, for water or other utility services (except for liens to discharge bonded indebtedness) is subordinate to any prior recorded lien on the property.

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§4.5 4. State and Federal Land Office Records

Disposal of State of California or United States public lands is within the jurisdiction of the State Lands Commission, an agency of the State Department of Conservation, and the Bureau of Land Management, Department of the Interior, respectively. Both agencies maintain internal land records of any conveyance of an interest in their respective public lands. Conveyances of fee title are in the form of "patents," which are recorded directly in the county recorder's office.

PRACTICE TIP: Title companies generally do not research state or federal land office records merely because the property owner is the state or federal government; a title company, however, probably will search those records in particularly sensitive cases (*e.g.,* if the property is wetlands, or a search of the public records did not uncover a recorded patent).

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§4.6 5. Environmental Lien Records

Under 42 USC §9607(*l*)(3), a provision of the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), to constitute constructive notice, environmental liens must be recorded or filed in the manner provided by state law. In California, these liens must be recorded in the office of the county recorder in the county in which the subject property is located to give constructive notice of their existence. See §4.7 for discussion of constructive notice. Once recorded, these liens are discoverable by a search of the official records of the county recorder. Accordingly, standard coverage policies do not include environmental liens in the definition of public records because to do so would be superfluous. As described further in §6.62, however, extended coverage policy forms define "public records" to include "any environmental liens filed in the records of the clerk of the United States district court for the district in which the land is located," thereby providing affirmative coverage against any such liens not listed unless they are set forth in the policy as exceptions to coverage.

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§4.7 6. Constructive Notice Imparted by Title Records

To impart constructive notice of an interest in real property to a third party, instruments in the records of the county recorder must:

- Be recorded by the county recorder of the county in which the subject real property is located (CC §1169);
- Contain the names of all persons, as then reflected in the public records, whose interests are affected (Govt C §27288.1);
- Sufficiently describe the subject real property (*Rowley v Davis* (1917) 34 CA 184, 190, 167 P 162) or refer to another recorded document containing such a description (*Krause v Marine Trust & Sav. Bank* (1928) 93 CA 681, 684, 270 P 246);
- Be properly executed and acknowledged by the required parties ("required parties" is not necessarily *all* parties but must include the owner for certain documents as provided in Govt C §§27287-27288); and
- Be properly copied into the public record and indexed (Govt C §§27322, 27323-27325).

Once these steps have been completed, subsequent parties will be charged with notice of the subject instrument and its terms and conditions, as well as that of all documents preceding the subject document in the chain of title.

It is increasingly common for developers of residential subdivisions to impose restrictive conditions on the incoming residents of the subdivision in an attempt to enhance their enjoyment of their homes and to maintain or increase property values. See *Zabrucky v McAdams* (2005) 129 CA4th 618, 620, 28 CR3d 592 (CC&Rs stated no "tree, shrub, or other landscaping [shall] be planted or any structures erected that may at present or in the future obstruct the view from any other lot"); *Dolan-King v Rancho Santa Fe Ass'n* (2000) 81 CA4th 965, 970, 97 CR2d 280 (protective covenant required that property improvements and structures be approved by the homeowners association with the written advice of the association's art jury "so as to insure a uniform and reasonably high standard of artistic result and attractiveness in exterior and physical appearance of said property and improvements"). Conversely, an "inclusionary housing development" may contain deed restrictions designed to keep the property affordable to buyers with very low to moderate income. See *Alfaro v Community Hous. Improvement Sys. & Planning Ass'n* (2009) 171 CA4th 1356, __ CR3d __.

Even if such restrictions are not contained in the current deed, they may nevertheless be enforceable under the doctrine of constructive notice. In 1995, the California Supreme Court described how to impose effective restrictive covenants (*Citizens for Covenant Compliance v Anderson* (1995) 12 C4th 345, 349, 47 CR2d 898):

> [I]f a declaration establishing a common plan for the ownership of property in a subdivision and containing restrictions upon the use of the property as part of the common plan is recorded before the execution of the contract of sale, describes the property it is to govern, and states that it is to bind all purchasers and their successors, subsequent purchasers who have constructive notice of the recorded declaration are deemed to intend and agree to be bound by, and to accept the benefits of, the common plan; the restrictions, therefore, are not unenforceable merely because they are not *additionally* cited in a deed or other document at the time of the sale.

This rule applies to both equitable servitudes and covenants running with the land. 12 C4th at 355; *Alfaro*, 171 CA4th at 1373 (rejecting attempted distinction between "use restrictions" and restraints on alienation).

PRACTICE TIP: The fact that the doctrine of constructive notice can make a restriction on use or alienation of the property enforceable even though it is not mentioned in the deed makes a search of the chain of title and title insurance essential.

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§4.8 7. Recorded Documents That Do Not Impart Constructive Notice

Many attorneys mistakenly believe that all recorded documents impart constructive notice to subsequent parties. Several kinds of documents may be recorded and become public records but do not create constructive notice. In *Stearns v Title Ins. & Trust Co.* (1971) 18 CA3d 162, 95 CR 682, the court held that surveys recorded under the Business and Professions Code did not impart constructive notice, because the statutes, while permitting recordation of surveys, did not state that such recordation would impart constructive notice. As the court noted in *Dreifus v Marx* (1940) 40 CA2d 461, 465, 104 P2d 1080:

> [T]he mere fact that an instrument has been recorded does not give constructive notice thereof unless there is some statute authorizing or permitting such instrument to be placed of record and at the same time making the effect of such recording constructive notice.

See also 3 Miller & Starr, California Real Estate §8:47 (3d ed 2000). See §§4.1, 4.7 for discussion of which recorded instruments do impart constructive notice.

"Wild" documents are another class of documents that, although recorded, do not impart constructive notice, because they are not in the chain of title. See §§4.23-4.25.

See California Real Property Sales Transactions §15.87 (4th ed Cal CEB 2007) for further discussion of "defective" documents that, although recorded, do not provide constructive notice.

PRACTICE TIP: If an insured believes that the title company has discovered an invalid or a defective document as a result of its title search, the insured should bring the matter to the company's attention and request that the document not be included as an exception to coverage. When a document is clearly invalid, title companies usually agree to remove the exception to coverage. When a document's validity is uncertain, a title company may be willing to remove the coverage exception but may request written confirmation from the insured, acknowledging that the policy to be issued does not cover that matter.

Whether a title company searches or examines recorded documents in the chain of title that do not give constructive notice is a subjective decision that varies from company to company. Title companies tend to be over- rather than under-inclusive in the items that they will reflect. In the *unusual* case of a title company's acting as an abstractor of title (see §5.25), the title searcher's duty to its customer is to exercise the skill of a professional abstractor in searching the public records and to report all matters that could affect the subject interest and that are discoverable in a reasonable search of the public records. *Lattin v Gillette* (1892) 95 C 317, 30 P 545; *Contini v Western Title Ins. Co.* (1974) 40 CA3d 536, 115 CR 257. As the court noted in *Contini*, however, a title insurer "can define the extent of his liability under the insurance policy" (40 CA3d at 545), unlike an abstractor, who is subject to a different duty of care. See also §5.28 explaining that title insurer is not insured's agent for purposes of constructive notice.

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§4.9 8. Effect of Actual Notice of Prior Unrecorded or Defectively Recorded Documents

The effect of actual notice to the insured or the company must be considered even if constructive notice is not given. See §§4.7-4.8 for discussion of what constitutes constructive notice. Extended coverage policies insure against certain "off-record" (*i.e.,* unrecorded) liens and encumbrances. See §6.8. But both standard and extended coverage policies exclude coverage for title defects not known to the title company but known to the insured and not disclosed to the title company. See §6.42.

A party who has actual knowledge, before obtaining title to or an interest in property, of a prior unrecorded interest for consideration will be subject to that prior interest, whether or not it is ever recorded. CC §§1107, 1214, 1217; see, *e.g., Brock v First S. Sav. Ass'n* (1992) 8 CA4th 661, 669, 10 CR2d 700.

EXAMPLE: A vendor's lien created under CC §3046 (an unrecorded lien in favor of the vendor of land to the extent the purchase price is unpaid and unsecured) is an instance of how such a prior unrecorded interest might arise. For example, if the title company knows that the seller/vendor is carrying back part of the purchase price by taking the buyer's unsecured note, the title company will except the vendor's lien from policy coverage. However, title companies typically delete such an exception by having the seller/vendor waive its vendor's lien rights under §3046.

Actual notice may also exist when a document was improperly recorded but a party was given notice by another means, such as a preliminary report. A grantee's actual knowledge may not, however, always result in the grantee's taking title subject to the effect of the interest in question.

EXAMPLE: If a statute provides that a particular lien or encumbrance is invalid or ineffective if not properly indexed and recorded, then even a purchaser with actual knowledge of that lien or encumbrance may be found not subject to it if it is not properly indexed and recorded. See, *e.g., TKB Int'l v U.S.* (9th Cir 1993) 995 F2d 1460, holding that a federal tax lien on real property, filed in the proper location but outside the property's direct chain of title, is invalid as to a subsequent purchaser for value who took the property with actual knowledge of the tax lien. The court found that, under the statutory federal tax lien framework, the actual notice of a subsequent purchaser is irrelevant; the statutes require that a specific procedure be followed as a precondition to the lien's validity as against subsequent purchasers.

Finally, aside from the issue of constructive notice, certain interests in real property must, by law, be recorded to be valid. See 3 Miller & Starr, California Real Estate §8:2 (3d ed 2000) for description of those interests. As a general rule, however, almost every instrument is valid and enforceable between the parties to a document and the parties that have actual notice of it, even if it has not been recorded. CC §1217.

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§4.10 B. Records Examined by Title Companies—The Title Company Plant

As a matter of practical business necessity, title companies have developed a system of collecting and organizing information derived from recorded documents into a body of records collectively known as the "title plant." See §4.1. The plant is composed of the title company's accumulated previously issued preliminary reports, guaranties, or title policies (starters) (see §4.17), and a collection of photocopies or abstracts of all documents recorded in the county or area served by the company.

A title company can streamline the process of searching titles by constantly updating its plant. The plant is organized by tracts, parcels, and lots of real property within its territory, in contrast to the cumbersome and inefficient grantor and grantee indexes maintained by the county recorders. By so reorganizing the public records at its own expense, the title company is able to make the rapid and accurate title searches required for the expeditious closing of transactions involving title or interests in real property. Computerization of the records and the search procedures used by most title companies greatly reduce the time required to search the records. See §4.22.

Because of the substantial start-up costs in developing a title plant, particularly a computerized plant, the use and sharing of the costs of a joint computerized plant by several title companies operating in a county is a common practice.

See §4.20 for discussion of how title companies keep the records in title plants current.

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§4.11 1. Types and Scope of Records Maintained

Title company plant materials are organized into three primary sets of books known as the lot books, arbitrary ("arb") books, and the general index (G.I.), and into various secondary files, such as tax records. Computerized recordkeeping may combine all these materials.

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§4.12 a. Lot Books

Historically, lot books have constituted the heart of the title plant. Rather than being indexed by the names of the grantor or grantee, lot books contain information pertaining to lots in recorded subdivisions (see California Real Property Sales Transactions §11.24 (4th ed Cal CEB 2007) for discussion of description of parcels by reference to recorded subdivision maps) and to quarter-quarter sections in areas covered by government survey of townships (see Real Property Sales §§11.17-11.21 for general discussion of government surveys).

Lot books have pages for each block or quarter section in the company's territory, with columns on each page for each lot or quarter-quarter section held in separate ownership. As the title company receives copies of recorded documents affecting each lot, it makes chronological entries in the page and column of the lot book indicating the date and type of instrument, identity of the grantee, and location of the document (*e.g.*, recorder's office filing indicia, court file number, title company order number). Also, entries are made showing the order numbers and dates of any title searches made by the company to enable subsequent searchers to locate starters on file (see §4.17). After proper entries have been made in the lot books, the abstracts or photocopies of the recorded documents are bound into books in chronological order. To keep the plant up to date, title companies try to enter this information as quickly as possible.

In modern urban areas, the computer has become the heart of the title plant, replacing lot books. Increasingly, a title search is performed by a computer analysis of a description of the property to be searched, using a computer program of factors affecting title to the property. See §4.22. A computerized plant is thus subject to the normal problems inherent in creating and accessing an electronic data base, in addition to the problems inherent in any title plant. In addition to possible "down time," computerized plants have been criticized as depriving the title officer of "the feel" for the title history of a particular parcel of property. Nonetheless, computerized plants have reduced costs and increased productivity considerably.

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§4.13 b. "Arb" Books

For parcels of land described in metes and bounds (see California Real Property Sales Transactions §§11.26-11.39 (4th ed Cal CEB 2007)) that are not part of recorded subdivisions or not subject to government survey, title companies have drafted arbitrary maps that indicate the location of each parcel held in separate ownership and assign an arbitrary lot number to each. Pages with columns referring to each parcel by arbitrary lot numbers are then assembled into the "arb" books. Title companies often use the tax assessor's maps as a book for the arb books. These books are made up, maintained, and used in the same manner as the lot books, and the title company records title information applicable to the "parcels" referenced. A few companies have combined their arb books with their lot books.

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§4.14 c. General Index

The general index, or G.I., contains references to all documents that affect land titles but that do not expressly describe any particular parcel of real property. Examples of those documents are marital settlement agreements, recorded abstracts of judgment, orders relating to federal and state tax liens, guardianship and probate proceedings, partnership records, powers of attorney, declarations of trust, blanket deeds, and judgments affecting personal status, such as change of name, bankruptcy, incompetency, and marital dissolution.

Because they cannot be indexed in the lot or arb books, these documents are indexed by the names of the parties involved. Thus, in the course of searching title, the title company checks all names in the lot and arb books against the general index to ascertain whether any other matters affecting title remain outstanding.

Many companies alphabetize names phonetically, rather than in strict alphabetical order, to detect matters that, despite minor errors or inconsistencies in spelling of names, the title companies believe may impart constructive notice under the rule of idem sonans (the same sound). This rule provides the rebuttable presumption that names that sound alike refer to the same person despite minor inconsistencies in spelling. See *Napa State Hosp. v Dasso* (1908) 153 C 698, 701, 96 P 355; 2 Miller & Starr, California Real Estate §6:17 (3d ed 2000). See also *McKinley Bros. v McCauley* (1932) 215 C 229, 9 P2d 298. Despite the older authorities mentioned above, the doctrine of idem sonans has more recently been held not to apply in the context of recorded document to give constructive notice to good faith purchasers for value. See *Orr v Byers* (1988) 198 CA3d 666, 244 CR 13, discussed in §4.24.

See §4.19 for discussion of how title companies use statements of identity to correctly identify parties to the transactions, especially those with a common name, in title searches.

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§4.15 d. Tax Records

Tax and assessment liens on California real property ordinarily arise on an annual basis. Because they affect title to property, title companies keep records of these liens in their title plants. Records of tax liens and delinquencies are commonly maintained as a separate part of the title plant because the assessing agencies frequently do not use the same property descriptions as those title companies use. The computerization of records by title companies has combined much of this material so that multiple searches need not be made. As noted in §4.4, supplemental tax bills and special assessment liens can cause difficulties for title insurers and have resulted in title companies' almost universally including special exceptions in preliminary reports and policies. See §6.51.

PRACTICE TIP: Counsel for the insured should request the title company to modify the exception to cover only supplemental taxes assessed *after* the policy date.

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§4.16 e. Other Sources of Title Records

Title companies also maintain a number of other files for use in title searches. Map files contain copies of all government surveys and recorded subdivision maps, together with copies of assessor's maps, private maps, and the company's own arbitrary maps. These files often contain copies of small maps for inclusion in preliminary reports and title policies.

Copies of "starters" (previously created preliminary reports, guaranties, or title policies) are kept for future use in title searches (see §§4.17, 4.20), as are copies of all other documents prepared by the company pertaining to specific parcels of land. In addition, title companies maintain general information or "opinion" files containing matters of a special nature, such as complex court decrees and trust arrangements, which may have a bearing on title at a future date.

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§4.17 2. Use of Starter Reports or Policies

As discussed in §4.20, title companies often use, as a basis for their title search, "starters" (previously prepared preliminary reports, litigation guaranties (see §9.9), trustee sale guaranties (see §9.6), or title policies), whether issued by the company itself or another title company.

EXAMPLE: A starter may be a copy of the title policy as provided by the seller, or a title company might acquire a starter from another title company through a joint operating title plant, or by buying the starter directly from the other title company.

In other instances, the title company may already have a starter in its own files. The company might then:

- Insure based on the starter;
- Perform a search for any event that might have transpired from the date of the starter; or
- Ignore the starter and perform a complete search.

If the title company uses a starter from another company without further search, it will be adopting any mistakes that may exist in the other company's starter.

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Source: Real Property/California Title Insurance Practice/4 Title Search and Surveys/§4.18 C. Title Company Searching Methods and Document Examination

§4.18 C. Title Company Searching Methods and Document Examination

The initial phase of title work relating to the public record comprises two related functions: The actual search for matters affecting title, and the analysis or examination of all relevant data found. Only after performing these two functions will the title company decide which matters to list in the policy as exceptions to coverage.

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§4.19 1. Statement of Identity

In searching records, title insurers often cannot ascertain whether a party to the transaction is the same party referred to in a document or someone else with the same or a similar name. Accordingly, title insurers often obtain a statement of identity or affidavit from a party to the transaction so that the title company can search only the appropriate names and properly identify the parties. The statement of identity or affidavit is a form requesting basic identifying information (*e.g.*, social security number, addresses of current and past residences, previous marriages). Once again, computerization of this information has greatly expedited its search. See also §2.34.

PRACTICE TIP: Some title insurers ask the seller and the buyer in all transactions to provide statements of identity as a matter of course. Other insurers request the statement only when, for example, the General Index (see §4.14) contains matters indexed under the name of the seller or buyer or when the seller or buyer has an especially common name (*e.g.,* Jones, Garcia, Smith, Lee).

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§4.20 2. Steps in Title Search

The searcher performs the function of searching title by ascertaining whether an earlier title search (starter) is on file for a particular title. See §4.16. If a starter is available, the searcher reviews all relevant records (including lot or arb books (see §§4.11-4.12), the general index (see §4.13), and tax records (see §4.14)) for items affecting that title from the date of the starter to the date of the search. If no starter is available, the searcher reviews the records back to the original title (federal or state patent, Spanish land grant, or other grant). In most instances, a starter is on file or is provided by the seller. Many title companies hastened the establishment of their title plants by purchasing from other companies sets of starters for particular counties.

The searcher then assembles in proper order all materials found, beginning with the starter and proceeding with abstracts or photocopies of subsequent items forward to the date of the search, together with pertinent maps, tax data, and any opinions rendered by attorneys on the effect of judicial proceedings on the title. The searcher then delivers them to an individual "examiner."

PRACTICE TIP: Even the most efficient title plant is usually about a week behind in compiling up-to-date records. To prevent potential gaps in coverage because of this time lag when an escrow closes, a title company employee usually first checks the records at the county recorder's office for the "gap" period immediately before recording the closing documents of a transaction. See §5.5.

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§4.21 3. Steps in Title Examination

The examiner analyzes the title and notes the items remaining unchanged since the date of the starter and any new matters affecting title that have not been cleared as of the date of examination. The examiner must confirm that there is no gap in conveyances among the parties to all documents in the chain of title, the legal description of the property, due execution of the documents, or the legal sufficiency of the successive transactions. More complex issues noted by the examiner may be brought to the attention of the examiner's supervisor, the legal staff, or the underwriting staff. The level of review afforded to these documents and other matters will depend in great part on the amount of time available and the level of risk and liability associated with the title policy to be issued. See §§4.22, 4.26-4.28.

Areas that often require a closer examination are judicial proceedings and any unpaid taxes or assessments. When a lis pendens, mechanics' lien, or attachment lien appears of record, the title company must consider the type of action, the validity of the action and the recording, the court's ability to grant relief, and the finality of any judgment. Because of the superior priority of tax and assessment liens, title companies must also review and consider the impact of all tax and assessment data. Tax foreclosures and protest proceedings are also generally reviewed. All this information is compiled into a preliminary report, which is delivered to the customer. For discussion of preliminary reports, see chap 5.

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§4.22 4. Computer Searches

The task of searching titles has changed over time. Technological advances in computer systems have radically changed the way title searches are completed. Today, it is common to perform a title search using a computer terminal simply to review the items that have been posted to a particular property, without performing a detailed examination of each individual document. Particularly in residential transactions, the title company may make an underwriting decision based solely on a review of the computer data. See §4.27. The title insurance industry is increasingly seeking to save time and money on the title search by using computers.

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D. Indexing Errors and Wild Documents

§4.23 1. Effect of Wild Documents

Documents that are improperly indexed or otherwise have a defect that prevents them from being discoverable in the "chain of title" by searching the grantor/grantee index do not impart constructive notice to subsequent parties. (On constructive notice, see §§4.7-4.8.) These documents are often referred to as "wild" deeds or documents. (On wild deeds, see §4.8.)

EXAMPLE: In *Far W. Sav. & Loan Ass'n v McLaughlin* (1988) 201 CA3d 67, 246 CR 872, the court held that the beneficiaries' deed of trust was a wild document and outside the chain of title when it was recorded before the trustor recorded its own grant deed to the property.

Although these documents may still be valid as between the parties to the document and other persons with actual knowledge of their existence, they will not be enforced to the prejudice of subsequent bona fide purchasers or encumbrancers for value, who had no such actual notice when they acquire their interests in the property.

PRACTICE TIP: If the county recorder acts willfully or negligently in recording or indexing a document, the recorder will be liable for damages to the injured party. Govt C §§27203-27203.5; *Cady v Purser* (1901) 131 C 552, 556, 63 P 844. See also Govt C §27320 (obligation of county recorder to record documents filed for record "without delay").

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§4.24 2. Problems With Misspelled, Common, or Different Names

A common error in recording documents is caused by misspelling one of the parties' names in a recorded instrument, resulting in the document's being indexed improperly in the grantor/grantee index. When a misspelling occurs, the issue may be raised whether the misspelling of the name imparts constructive notice to the title searcher under the doctrine of idem sonans (the same sound—*i.e.*, names that sound the same will be treated the same; see discussion in §4.14). The court in *Orr v Byers* (1988) 198 CA3d 666, 244 CR 13, held that the doctrine of idem sonans was appropriate for purposes of identification, but refused to apply this principle to a situation in which constructive notice to good faith purchasers for value was at issue. Specifically, the court stated (198 CA3d at 671):

> In refusing to apply the doctrine [of idem sonans] here, the trial judge found that requiring a title searcher to comb the records for other spellings of the same name would place an undue burden on the transfer of property. The court observed "if you put the burden on those people in addition to what comes up when the name is properly spelled, to track down and satisfy themselves about whatever comes up when the name is improperly spelled in all different ways that it might be improperly spelled, it leads to, I think, an unjustifiable burden." We agree.

The decision included a discussion of software and computer systems developed for the title insurance industry that sought to deal with the doctrine of idem sonans. The court felt that despite those systems and software, the burden was properly placed on the person seeking to impart constructive notice by requiring that person to spell the name correctly.

Under federal tax law, a tax lien is valid if it has been entered and recorded in the public index so that a "reasonable inspection of the index" is adequate to permit the public to discover its existence. IRC §6323(f)(4). It is fairly common for taxpayers to use several different names, and the tax lien may not be indexed under the name that the taxpayer used when he or she acquired title to the subject property. Therefore, the question arises whether a reasonable inspection of the index would disclose the fact that the taxpayer named in the recorded lien is the person who acquired the property. In *Kivel v U.S.* (9th Cir 1989) 878 F2d 301, the Ninth Circuit Court of Appeals held that, at least for purposes of federal tax liens, to determine what effect information in the document will have, the person searching the index must look at the recorded documents and not simply at the description in the index. In *Kivel*, an examination of the documents would have shown that the person subject to the federal tax lien had used other names.

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§4.25 3. Effect of Search Revealing Wild Documents

A title company performing a search may actually find a "wild" document in the title company's plant (perhaps because of a different method of indexing than that used by the county recorder). Other than documents that can be easily verified from examination of the record not to apply, most title companies will show all erroneous documents as exceptions to coverage in their reports and policies. By delivering a preliminary report to a potential insured before he or she acquires an interest in the property, the title company gives such person actual notice of any wild document shown in the report, destroying that person's ability later to claim the benefit of bona fide purchaser or encumbrancer status.

PRACTICE TIP: Buyer's counsel may wish to instruct the title company to exclude references to wild documents in any preliminary reports or policies so that the client will not be charged with actual notice of the document. See §§11.38-11.41.

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§4.26 II. UNDERWRITING DECISIONS

"Underwriting" is a title company's process of deciding for a particular transaction whether to issue a preliminary report or policy, what exceptions to coverage will be included, which endorsements will be issued, and any number of other decisions on the conditions under which the title company will insure the property. Sections 4.27-4.29 discuss the various factors title companies use in making underwriting decisions.

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§4.27 1. Limitations on Title Searches

Because company practices vary so widely, counsel should be aware of several factors that may bear on the decision to issue a preliminary report or a title insurance policy and, if so, which items to include as exceptions to coverage. Counsel should *not* assume that the title company has performed a complete search. In fact, contrary to popular notion, most title searches are not original, complete searches going back to an original sovereign land grant or patent, and continuing through to the date of the transaction. As noted in §§4.17, 4.20, many if not most title searches begin with a "starter" and are updated by a computer search. See §4.22.

Title insurance is a risk-avoidance industry. Theoretically, a title company could probably attain a near-zero loss ratio if, in every transaction, it spent enough time to thoroughly search the property's chain of title. Realistically, however, it is not cost-effective to undertake a complete search in every transaction, and title companies experience losses because of time constraints, mistakes in searching, and hidden defects not ascertainable by the most thorough search such as fraud, forgery, and lack of authority. Snyder, *Title Insurance: An Industry on the Verge of Transformation*, Best Wk Prop/Cas Supp, p/c 1, p/c 3 (Apr. 15, 1996). Accordingly, title companies make policy and business decisions about the level and thoroughness of its searches, and the amount of risk they are willing to accept in a particular transaction or class of transactions. The level of search is primarily based on the title product requested.

EXAMPLE: Most title companies have made a business decision to "short chain" searches in single-family residential transactions, *i.e.,* the searcher will go back only as far as the property was last insured for a first deed of trust, and go forward in the search from there.

EXAMPLE: Title companies are usually much more cautious in handling commercial searches than residential searches because of the potential higher liability exposure. In commercial transactions, the title company's major decision is how far back to search. The extent of the search will depend on a variety of factors. For example, if the property has been active and conveyed several times recently, the more likely the title is correct and liens properly identified because the title has been searched so often. Other factors are the complexity of the project as a whole, the property's location (*e.g.,* title companies are more cautious about waterfront property), time constraints on the project, and possibly a previous good business relationship between the title company and the buyer.

PRACTICE TIP: Buyer's counsel should ask the title company about the thoroughness of its search. If circumstances or the client dictates that a more thorough search be conducted, counsel should communicate this request to the title company and then confirm that the required search was done.

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§4.28 2. Conflict Between Time Constraints and Thoroughness of Search

Sometimes potential insureds will pressure the title company to complete a preliminary report and close the transaction quickly. This situation can create a strain between the escrow officer (who wants to accommodate the insured) and the underwriter or title officer (who wants to perform a complete search). From the title company's perspective, a customer who insists on "rushing" the title search may someday tender a claim for title problems or a claim that falls within exclusions from coverage (*e.g.,* "made, suffered, or assumed" (see §6.41); "off-record defect known to insured and not disclosed to title insurer" (see §6.42)).

PRACTICE TIP: A title company can accommodate a customer who demands rush service by accepting an indemnity (*e.g.,* from the seller) to "write around" (see §§5.40-5.41) a potential problem. The indemnity, however, is only as good as the financial strength of the indemnitor. If the indemnitor is a highly leveraged developer, the indemnity will be of questionable value and not acceptable to the title insurer.

Although a title company may be willing to accept the risks inherent in doing a rush search and issue a policy, the result may be a problem with the underlying transaction that forces the insured to pursue a title claim.

PRACTICE TIP: It is always a good idea for counsel to ask the title company about the type of search that has been completed. Although the insured's time constraints may require an expedient search, the attorney should discuss with the client the risks of giving the title company an inadequate opportunity to search the record of title or limiting the scope of the search.

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§4.29 3. Decisions Affecting Specific Transactions

In additional to treating classes of transactions differently for underwriting purposes (see §4.27), title companies are often requested to make underwriting decisions about specific exceptions to coverage and other matters in individual cases. As noted in §4.27, several factors influence the decision the title company will make in a particular case for a particular exception.

EXAMPLE: The buyer proposes purchasing property that lacks a recorded right of access to a public street. The seller, however, has relied for years on an "off-record" access right over adjoining property. Based on the long-standing off-record access right, buyer's counsel asks the title company not to remove the policy provision insuring a right of access to the property.

Decisions on whether to give access coverage in the absence of an adequate recorded easement are made by the title insurer after an analysis of several factors. How long has the off-record access been used? How many servient property owners are there? How many dominant properties use the access? Does the prospective insured intend to change the use of the dominant property? (Even though the policy insures as of the Date of the Policy, the question is important to the insurer because a change in use, such as a change from residential to farming involving large trucks and tractors is likely to raise neighbors' opposition, which can lead to claims by the servient property owners denying the existence of any prescriptive rights.) Is the access improved and who paid for it? Who pays for maintenance? Are there any gates? Any locks? Who has keys? Has there been any litigation over the access? Any letters or verbal disagreements? Are there any known claims that the access is by revocable license rather than adverse? Was there past common ownership of dominant and servient parcels that would support other of-record easement rights, such as an easement by necessity? Has the insurer or other insurers previously insured without an access exception?

The underwriter analyzes the answers to these questions to decide whether it is willing to issue the policy without deleting the access coverage.

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III. SURVEYS

§4.30 A. Different Types of Land Surveys

Buyers of multifamily or commercial real property and, in unusual cases, buyers of single-family residences often find it desirable to obtain a current survey of the property by a licensed surveyor or civil engineer. A survey will show the exact acreage, the existence of any encroachments and party walls, boundaries, compliance with setback requirements, easement locations, and the nature and location of access. See California Real Property Sales Transactions §§4.58-4.59 (4th ed Cal CEB 2007). See §4.34 for discussion of advice that buyer's counsel should give its client regarding surveys; see §4.31 for discussion of when the title company requires a survey as a condition of issuing an extended coverage title policy.

There is no universal criteria for what constitutes a survey. Surveys vary, depending on the parties' intent and the particular transaction. Generally, the surveyor will measure and plot the property based on previously agreed-on standards and criteria to provide the detail needed by the party requesting the survey.

EXAMPLE: Surveys may be topographical, perimeter, as-built, aerial, or ALTA surveys. See §4.32.

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§4.31 B. Extended Coverage Inspection and Survey Requirements

Extended coverage policies, by their terms, cover off-record matters. Thus, title companies must more closely examine certain physical aspects of the subject property to evaluate its potential for off-record matters. See chap 6 for discussion of coverage afforded under standard and extended coverage policies. Standard coverage title policies do not require a survey but include an exception for encroachments, boundary line disputes, or other matters that would be disclosed by an accurate survey or inspection of the premises. See §6.51. If an insured requests a title company to issue an extended coverage owners' or lenders' policy of title insurance, the title company will require a survey.

Once an acceptable survey is provided (see §4.33), the standard exception will be replaced with an exception for any matters shown on the survey, to the extent they are not already shown as exceptions to title coverage.

PRACTICE TIP: Sometimes the title company includes a very general exception for any matter shown on the survey, without stating specific items. Most insureds will not accept this approach and require the title company to state specific exceptions. As discussed in §4.34, affirmative coverage for items shown on the survey, such as encroachments, can then be negotiated.

Standard coverage policies include an exception for any facts, interests, or claims that are not shown by the public records but that could be ascertained by inspecting the land or asking persons in possession of the land. See §6.51. Because this exception is not included in extended coverage policies, it is a practice of title companies to perform an inspection and inquire about persons in possession of the property (usually by comparing the names listed on a rent roll to the names of persons actually in possession). Based on the results of this inspection, the title company may add additional exceptions to coverage, such as possible encroachments or rights of parties in possession that are observed on the property.

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Source: Real Property/California Title Insurance Practice/4 Title Search and Surveys/§4.32 C. ALTA Survey

§4.32 C. ALTA Survey

To be acceptable to most title companies (see §4.31), the survey obtained by or on behalf of the insured and delivered to the title company must satisfy the "Minimum Standard Detail Requirements and Classification for ALTA/ACSM Land Title Surveys" adopted by the American Land Title Association and the American Congress on Surveying & Mapping in 1992. The Minimum Standards may be obtained by contacting the American Land Title Association (see Directory). Such a survey is commonly called an "ALTA survey."

The basic requirements of the Minimum Standards are as follows:

- Written authorization to conduct a survey provided by the person paying for the survey, specifying the type of survey to be made, which varies in terms of the accuracy standards.
- Designating which of the optional items listed in Table A of the Minimum Standards are to be incorporated into the survey, together with a record description of the subject property, any record documents affecting the property, and the names of the owners of the subject property and the adjacent property.
- The surveyor's name, address, telephone number, and signature; the surveyor's official seal and registration number; the date the survey was completed and the dates of all revisions; the required form of certification by the surveyor; and certain scale and legend requirements.
- Satisfaction of the specified performance guidelines for the survey and required items of information, including:
- A boundary survey (if the record boundaries differ from the boundaries measured by the survey, both bearings are to be indicated);
- Measured and record distances from the corners of the surveyed parcel to the nearest right-of-way street lines, together with names and widths of streets, as well as other access information;
- All recorded plats, maps, and right-of-way maps with recording information and the names of adjoining owners as they appear of record, plotted and setback or building restriction lines that appear in recorded documents delivered to the surveyor, and parcel lines, which must indicate contiguity, gores, and overlaps;
- All evidence of monuments, with notations of which were found and which were placed, including any outside the surveyed premises in establishing the corners of the premises;
- Any evidence of possession;
- The location of all buildings on the parcel with locations relative to the surveyed property boundaries, together with the street address of the buildings;
- Easements benefiting and burdening the surveyed property in evidence by recorded documents, with notations for easements that cannot be located, as well as observable evidence of easements found on the surveyed property;
- All driveways, alleys, walls, buildings, fences, and other visible improvements within five feet of either side of the boundary lines, to be shown by their character and location, including all encroachments by or on to the adjoining property, adjacent streets or on any easements or setback lines; and
- Cemeteries and burial grounds, ponds, lakes, springs, or rivers either boarding on or running through the premises.

The Minimum Standards also set forth minimum angle, distance, and closure requirements for the various classes of surveys.

Table A of the Minimum Standards sets forth a number of optional items that can be requested in connection with a survey. Institutional lenders and purchasers, many of whose headquarters are in locations distant from the property, often request such items to ensure that they have identified all physical issues associated with the property. They include various basic physical attributes of the property, such as zoning compliance, flood zone compliance, location of utilities, and capacity of parking areas. These matters go beyond title company requirements in most instances (*i.e.*, unless special endorsements are required, such as a zoning endorsement that states the applicable parking requirements).

PRACTICE TIP: Despite the survey and inspection requirements under an extended policy, an insured or its counsel

should negotiate with the title company to learn whether these requirements can be waived, modified, or eliminated as exceptions from coverage. In general, lenders will always get more favorable treatment in this area because it is much less likely that a lender will ever hold title to the property (*e.g.,* through foreclosure), and therefore acquire a claim against the company; title companies perceive that the risk of loss is much less for a lender than an owner. Before ordering a new survey, insureds should confirm with the title company what will constitute an acceptable survey. For example, many title companies will accept something less than an ALTA survey, or will accept an older ALTA survey if a satisfactory inspection can be performed by the title company. See also the Practice Tip in §2.18 for discussion of factors the title company will consider in deciding whether to waive the survey requirement.

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§4.33 D. Review of Survey by Title Company

In reviewing an ALTA survey, the title company's primary role is to confirm that the survey conforms with the ALTA/ACSM Minimum Standards described in §4.32. As with most title review matters, however, the level of review of an ALTA survey by the title company will be dictated by the company's internal policies and will vary depending on the circumstances and the amount of insurance to be issued. Once the title company has confirmed that the survey complies with the ALTA/ACSM requirements and any other of its own internal requirements, it will state any additional exceptions to coverage shown in the survey in its preliminary report or title commitment. The exceptions in the preliminary report or title commitment will be included in the title insurance policy to be issued, unless they are otherwise eliminated. See §§2.22-2.27 for discussion of negotiating elimination of exceptions with title companies.

Insureds usually negotiate for affirmative coverage for matters such as encroachments or access if problems are reflected in the survey. See §2.20, chaps 7-8 on these coverages.

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§4.34 E. Review of Survey by Insured's Attorney

Attorneys, particularly those representing institutional lenders or purchasers, are often requested to review a survey in detail. Because most attorneys, even experienced real property attorneys, are unfamiliar with the matters in an ALTA survey, this task can be difficult and tedious. It is important, however, because it may disclose essential items for the attorney's overall due diligence of the subject property. The attorney's ability to read a survey, however, is crucial because it not only aids the attorney's review of title but enables the attorney to offer the client advice and insight into the client's planned development and use of the property.

Once an attorney understands the basics of survey reading, it is not difficult to review an ALTA survey. For guides to understanding surveys, see Estopinal, A Guide to Understanding Land Surveys (2d ed 1993); Snediker, *Surveys in Title Insurance*, 39 Prac Law 55 (Apr. 1993); York, *Surveys in Real Property Transactions*, 5 CEB Real Prop L Rep 121, 145 (Oct.-Nov. 1982); Cummins, *Comment on Surveys in Real Property Transactions*, 6 CEB Real Prop L Rep 57 (Apr. 1983). Counsel's primary role in reviewing a survey is to confirm that the client's requirements, which may differ from the ALTA/ACSM Survey Minimum Standards (see §4.32), have been satisfied.

The attorney's review of the survey should also be coordinated with the attorney's review of the preliminary report, which may disclose additional items for which the attorney should negotiate additional affirmative coverage by way of endorsements on behalf of the client. This review should not be limited to confirming that the Minimum Standards have been satisfied. The attorney should request that all recorded exceptions be set forth on the survey with their recording information, not merely plotted onto the survey at their locations as the Minimum Standards require.

PRACTICE TIP: Counsel should confirm with the surveyor that all easements and other physical exceptions have been plotted by both a reference to the legal description in the preliminary report and a reference to the surveyor's actual physical inspection of the easement or other exception on the property.

Attorneys should also review encroachments onto adjacent property or easement areas, particularly any giving rise to setback violations. The survey should be reviewed for physical evidence of off-record easement rights, such as openings in fences or walls, and the existence of paths or roads. Purchasers' and lenders' counsel should carefully review the record owner vesting shown on the survey to confirm that it is consistent with the preliminary report or title commitment and with the names of the parties executing the purchase and sale or lending documents. In addition, the attorney should confirm whether parking requirements can be satisfied on the property itself, and should have this matter reflected on the survey. Frequently, the property owner relies on an off-site parking agreement to comply with parking requirements, but the lender or new owner may not have rights under that agreement. In this context, the lender may need to obtain additional rights under the off-site agreement that would become effective if the lender foreclosed on the property.

The attorney should confirm that a CLTA 116.1 endorsement will be issued in connection with the policy. That endorsement incorporates the survey by reference and indicates that the property shown on the survey is the same property covered by the policy. See §§7.95, 8.93-8.94 for discussion of the CLTA 116.1 endorsement.

PRACTICE TIP: Because surveys are expensive, lenders and purchasers are often unwilling to request them. The costs may later appear minimal, however, compared with losses that may arise as a result of incomplete information on the subject property. Some circumstances in particular dictate that a survey be made (*e.g.,* transactions involving new building construction, vacant land with new construction planned, or older structures with additional construction planned). In such instances, the attorney should recommend a survey or negotiate with the title company to eliminate the survey requirement and survey exceptions to coverage. See Practice Tip in §2.18 on attorney's obligation to recommend that the client obtain a survey; see §4.32 for discussion of when title companies might eliminate a survey requirement.

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5

Preliminary Reports and Commitments

Alice L. Akawie

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I. PRELIMINARY REPORTS

§5.1 A. Purpose

A preliminary report is generally obtained at the inception of a real estate transaction—in a purchase and sale transaction, following the execution of the purchase agreement; in a loan transaction, following the issuance of a commitment letter; and in a lease transaction, following the execution of a letter of intent. Preliminary reports are "furnished in connection with an application for title insurance and are offers to issue a title policy subject to stated exceptions… and such other matters as may be incorporated by reference." Ins C §12340.11. The preliminary report informs the prospective buyer, lender, or tenant of any liens, defects, or encumbrances that will be shown as exceptions to coverage in a title insurance policy. The preliminary report *does not* reflect the actual state of title to the property. On liability of issuer of preliminary report, see §§5.25-5.29. See also §13.4. Usually, the preliminary report serves as a starting point for the issuer and the prospective insured to negotiate the scope of title insurance coverage.

PRACTICE TIP: A buyer or a lender may also want to obtain a preliminary report before signing a binding agreement in order to verify the identity of the vested owner or to learn whether there are any indications that the seller or the borrower is in financial distress, which may be indicated by recorded tax liens, abstracts of judgments, lis pendens, *etc*. The buyer or lender will need to consult with the title company about any charge for the preliminary report if no insurance policy is ultimately issued.

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§5.2 B. Contents

The preliminary report states that the title company is prepared to issue a policy (1) describing the land, the estate, or the interest set forth in the preliminary report, and (2) insuring against loss sustained because of any defect, lien, or encumbrance that is (a) not shown as an exception on the preliminary report and (b) not excluded from coverage by the schedules, conditions, and stipulations of the policy. For copies of the CLTA preliminary report forms, see App C for the 1995 form; App D for the 2004 form; and App E for the 2006 form. On the attorney's role in reviewing the preliminary report, see §§2.5-2.11.

The 2004 CLTA preliminary report is substantively similar to the 2006 version, with the following exceptions:

- The 2006 form includes sections setting forth the exclusions and exceptions found in the 2006 ALTA owner's and loan policies; and
- The 2006 form contains the following statement not found in the 2004 form: "The policy to be issued may contain an arbitration clause. When the Amount of Insurance is less than that set forth in the arbitration clause, all arbitrable matters shall be arbitrated at the option of either the Company or the Insured as the exclusive remedy of the parties." See the discussion of *Kleveland v Chicago Title Ins. Co.* (2006) 141 CA4th 761, 46 CR3d 314, in §14.7.

The preliminary report consists of the following:

- Cover page (see §§5.3-5.7),
- Exclusions from coverage (see §5.8),
- Preprinted exceptions (see §5.8), and
- Typewritten exceptions (see §§5.9-5.19).

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§5.3 1. Cover Page

The cover page of the preliminary report identifies the title company issuing the report, the title officer responsible for title issues and issuing the title report, and the type of policy (ALTA or CLTA) that the title company anticipates issuing. (The title industry has standardized title policy provisions through the California Land Title Association (CLTA) and the American Land Title Association (ALTA), which develop and publish the most widely used forms.) The cover page of the ALTA preliminary report also includes two numbers: "Your No." refers to the file number of the company *ordering* the preliminary report. "Our No." refers to the order number of the title company *preparing* the report. The policy number is generally not assigned until the title policy is prepared.

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§5.4 a. Explanation of Purpose and Scope; Disclaimer of Liability

The cover page also includes a statement explaining the purpose and scope of the preliminary report. It advises the addressee to review the form policy, which is available from the title company but which does not automatically accompany the preliminary report. Most important, it states that the issuance of the preliminary report does not create liability. If the insured wants the title company to assume liability before the title policy is issued, the insured should request either a commitment or a binder. See §§5.31-5.38 for discussion of commitments. See §§3.20-3.22 for discussion of binders.

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Source: Real Property/California Title Insurance Practice/5 Preliminary Reports and Commitments/§5.5 b. 'As of Date'

§5.5 b. "As of Date"

The date shown on the cover page (the "as of date") is not the date the preliminary report is issued; it is the last date of complete posting to the title plant or the data base that was used in compiling the report. On title plants, see §§4.10-4.17. If activity relating to title has occurred since the date of the report, a gap in title information may be created. If the escrow period is lengthy, a title company may update its report as the transaction progresses. Updates may also be issued when an ALTA survey is completed or on request of a proposed insured. On ALTA surveys, see §4.32. When escrow closes, the title company avoids the risk of any gap by "dating down" the title from the last update of the title search to the recording date.

PRACTICE TIP: The purchase agreement should give the buyer enough time to review and approve not only exceptions to coverage shown on the original preliminary report but any new exceptions shown on a supplemental or an amended preliminary report. If the title company discovers an exception before closing (whether an existing one previously overlooked or a new one recorded after the date of the title search), (1) the transaction may be terminated, or (2) the closing may be delayed until the parties remove the exception, the buyer accepts the exception, or the title company agrees to issue an endorsement extending coverage over the exception.

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Source: Real Property/California Title Insurance Practice/5 Preliminary Reports and Commitments/§5.6 c. Current Vesting

§5.6 c. Current Vesting

The cover page further identifies the estate or the interest of the current property owner. A vital piece of information on the cover page is the description of how title is presently held.

PRACTICE TIP: Seeing the preliminary report may be the first time the buyer learns that property is not vested solely in the seller. Instead of an individual seller, the buyer may discover that a partnership, a corporation, a trust, or joint tenants actually hold fee title. Whenever the seller is not the sole fee owner, the buyer's attorney should confirm that the putative seller is authorized to act on behalf of the fee owner. The seller's attorney will also need to provide the title company with appropriate documentation showing authority to convey the property. For further discussion of authorizing documents, see §§2.29-2.34. If the power to convey is conferred by a recordable power of attorney, a copy of the power of attorney should be given to the title company as soon as possible for review and approval.

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Source: Real Property/California Title Insurance Practice/5 Preliminary Reports and Commitments/§5.7 d. Legal Description

§5.7 d. Legal Description

The preliminary report also provides the legal description of the property that is the subject of the report. Sometimes a copy of a recorded subdivision map or an assessor's parcel map is attached to the preliminary report purely for informational purposes.

PRACTICE TIP: Counsel should verify that the legal description and the assessor's parcel number correspond to the legal description in the purchase and sale agreement, deed of trust, lease, or other relevant transfer or financing document.

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Source: Real Property/California Title Insurance Practice/5 Preliminary Reports and Commitments/§5.8 2. Exclusions and Preprinted Exceptions

§5.8 2. Exclusions and Preprinted Exceptions

A preliminary report discloses the exclusions and preprinted exceptions that will appear in the proposed title policy. See §§6.34-6.48, 6.50-6.54 for further discussion of exclusions and preprinted exceptions.

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§5.9 3. Typewritten Exceptions

Typewritten exceptions apply only to the specific property to be insured. The title company does not insure against loss or damage that arises by reason of the exceptions. The insured's attorney must review these exceptions carefully to see whether they are acceptable. They may affect the insured's proposed use of the property or its value. If a matter is unacceptable, the insured, if permitted by the relevant transfer or financing document, may object to an exception and request (or require, if allowed) the owner to have the exception deleted form coverage before close of escrow. See also §§6.55-6.57.

PRACTICE TIP: It is important that the proposed insured object to an exception in a timely manner under the terms of the purchase and sale agreement, deed of trust, lease, or other relevant transfer or financing document. The person responsible for removing the exception has several options, some of which are described more fully in §§5.21-5.24, 5.39-5.44.

Exceptions to coverage include such matters as covenants, conditions and restrictions (CC&Rs), easements, liens, and encumbrances. Copies of all recorded instruments described or mentioned in the exceptions are available from the title insurer, but they are usually furnished only on request. Counsel should review copies of all exceptions, except for minor exceptions that will not affect the value or use of the property and exceptions to be removed at or before closing (such as a deed of trust, which will be reconveyed at closing). See §§2.5-2.11 for further discussion of the attorney's role in reviewing preliminary reports.

It is important to understand that the typewritten exceptions do not necessarily reflect all title defects, liens, and encumbrances against title. The title company may have missed something in its search, or it may have made a deliberate underwriting decision not to list a matter. In any event, the title company issuing the preliminary report is not responsible for a failure to include exceptions to title. *Siegel v Fidelity Nat'l Title Ins. Co.* (1996) 46 CA4th 1181, 54 CR2d 84. See §§5.25-5.29 on preparer's liability.

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Source: Real Property/California Title Insurance Practice/5 Preliminary Reports and Commitments/§5.10 a. Easements

§5.10 a. Easements

Counsel for buyers and lenders should review any easements on the property to ascertain whether they grant the holder of the easement (1) rights that might interfere with the intended use of the property or might affect its value or (2) reciprocal rights that might benefit the property. If the easement is exclusive, the proposed insured may want to renegotiate its terms (or have the terms renegotiated by the seller or borrower), especially if the use of the property will change after close of escrow. Among the matters buyers and lenders should evaluate are:

- Rights of access;
- Rights and/or obligations to repair, maintain, or relocate the easement;
- Rights to trim trees on the property;
- Rights of the servient tenement holder (*i.e.*, holder of the burdened property) to rebuild a damaged structure if the easement runs under the structure;
- Rights of the dominant tenement holder (*i.e.*, holder of the benefited property) to remove a structure to make repairs, and its obligations to rebuild the structure if the easement runs under it; and
- Rights of holders of reciprocal parking easements (commonly used in shopping center properties—reciprocal parking easements may adversely affect further development of a center if they are too inflexible).

PRACTICE TIP: If the easement involves common use by both the grantor and the grantee of the easement (such as a driveway easement on residential property), the buyer's attorney should consider having an easement maintenance agreement. Among other things, the agreement should allocate the cost of maintaining the easement and provide mechanisms for hiring and paying a contractor and for dispute resolution. Although such an agreement is easiest to obtain at the time the easement is created, it may be possible to obtain one at a later date. See Akawie, *A Practical Guide to Easements*, 14 CEB Real Prop L Rep 186 (July 1991) for a more detailed discussion of drafting easement and easement maintenance agreements. If there is no maintenance agreement, CC §845 establishes a method of sharing costs.

Buyers and lenders should ascertain the physical location of easements on the property. The title company, as an accommodation, may locate easements on the property map that generally accompanies the preliminary report, but the title company does not intend in doing so to assume responsibility for their location. Typically, the title company stamps such maps with a disclaimer stating that it is being provided for informational purposes only.

The easements should be located on an ALTA survey, if available, particularly for commercial properties.

PRACTICE TIP: The actual location of an easement cannot always be established by plotting the easement on a survey, because the easement may not have been placed in the location described in the recorded deed of easement. An inspection of the property may be necessary to confirm where the easement actually lies.

If a survey is not obtained, counsel should advise the buyer of the risk that the easement may interfere with the buyer's proposed use of the property. On surveys, see §§2.13, 4.30-4.34. Lenders will also want an easement plotted if it could potentially affect the value or interfere with the proposed use of the property.

PRACTICE TIP: In deciding whether to recommend an ALTA survey, counsel should keep in mind the nature of the easement and, if known, its location. For example, an easement for power lines in an area that cannot be built on because of set-back restrictions generally would not require a survey to locate its placement.

A title company may be willing to insure against a loss caused by the exercise of an easement, depending on its nature and extent, its location, and the insured's proposed use of the property. On endorsements over easements (CLTA 100 and 103 series), see §§7.72-7.73, 8.55, 8.59-8.60, 8.75-8.76.

EXAMPLE: Easements that title companies may insure over include ancient easements that fall within the Marketable Record Title Act (CC §§887.010-897.090) or older easements that appear to have been abandoned or that were created for uses that no longer exist. On ancient instruments, see §5.22.

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§5.11 b. Encroachments

An encroachment (*i.e.*, a structure or tree that extends onto adjoining land or airspace without appropriate consent) is shown on an initial preliminary report if (1) the title company anticipates issuing an ALTA extended coverage policy, (2) the encroachment is disclosed in a recorded document, or (3) the title company otherwise has knowledge of it. (Generally, a title company will know of an encroachment if it previously issued an ALTA policy on the property.) Otherwise, an encroachment is usually shown in an amended or a supplemental preliminary report after a survey has been obtained.

As with easements, buyers and lenders should locate encroachments on a survey and decide whether their removal, if required by the adjoining landowner, will interfere with the intended use of the property or materially affect its value. On surveys see §§2.13, 4.30-4.34.

PRACTICE TIP: Encroachment problems may also be solved through a lot line adjustment (see California Subdivision Map Act and the Development Process §§2.17-2.23 (2d ed Cal CEB 2001)) or a quiet title action (see California Real Property Remedies and Damages, chap 7 (2d ed Cal CEB 2002)). A preventive measure is the recordation of a notice of consent to use. CC §813.

Also, buyers and lenders may have to determine whether an encroachment has become permanent (*i.e.*, whether an adjoining landowner has obtained rights in the property to be insured by virtue of the nature and duration of the encroachment). See *Kafka v Bozio* (1923) 191 C 746, 218 P 753. See also §§7.72-7.73, 8.75-8.76 on CLTA 100 and 103 series endorsements for coverage against forced removal of encroachments.

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Source: Real Property/California Title Insurance Practice/5 Preliminary Reports and Commitments/§5.12 c. Covenants, Conditions, and Restrictions

§5.12 c. Covenants, Conditions, and Restrictions

Buyers and lenders should review any covenants, conditions, and restrictions (CC&Rs) encumbering the property. The CC&Rs may contain a right of reverter in favor of their creator. For either a buyer or a lender, such a right can prove disastrous. If the condition triggering the right of reverter occurs, title to the property will transfer out of the owner's name and the lien of any deed of trust recorded after the CC&Rs were recorded will become ineffective. The CC&Rs may also contain covenants limiting the owner's use of the property. Sometimes the CC&Rs can be renegotiated to allow the purchase or loan to proceed. Other items of importance in the CC&Rs are cross-easements, assessments, and common areas. For further discussion of CC&Rs, see Advising California Common Interest Communities, chap 7 (Cal CEB 2003); Forming California Common Interest Developments, chap 7 (Cal CEB 2004). On endorsements related to CC&Rs, see §§7.80-7.83, 8.71-8.72.

PRACTICE TIP: Counsel should advise buyers that the CC&Rs may be binding even if they are not mentioned in any deed to the property. See *Citizens for Covenant Compliance v Anderson* (1995) 12 C4th 345, 47 CR2d 898, holding that CC&Rs which establish a common plan for ownership of property are binding on subsequent purchasers even if not referred to in a deed if the subdivider recorded the CC&Rs before selling any lots in the subdivision.

Lenders also must consider the effect CC&Rs may have on foreclosure of their deeds of trust. Most properly drafted CC&Rs, including the standard FNMA-approved form for residential condominiums, contain mortgagee protection provisions. These include provisions that free a lender who forecloses or obtains title by deed in lieu of foreclosure from the obligation to cure defaults that could only be cured by the prior owner or that are impossible or impractical to cure. Absent such language, a beneficiary can find its deed of trust the subject of an action by the homeowners' association to enforce the CC&Rs. For this reason, a lender should not lend in these circumstances or should make the amendment of the CC&Rs a condition of the loan. See Common Interest Developments §6.8 and chap 7.

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§5.13 d. Financing Liens

A buyer who intends to either assume existing financing or take title subject to it, and a lender who intends to lend in a junior position, should review the documents that create or secure the existing financing. The financing documents normally recorded are the deed of trust, the assignment of rents, a secured environmental indemnity, and a fixture filing. Other significant financing documents not usually recorded are a loan agreement, a promissory note, an unsecured environmental indemnity, and a security agreement. On financing documents generally, see California Real Estate Finance Practice: Strategies and Forms (Cal CEB 2000).

The junior lender must ascertain whether the senior deed of trust contains a due-on-encumbrance clause (a clause providing that the entire outstanding principal balance of the loan must be paid if the property is further encumbered) and/or a due-on-sale clause (a similar clause with repayment due on a transfer of the property). The former affects the lender's ability to make the loan; the latter affects the junior lienholder's ability to foreclose because the senior lienholder may assert that a foreclosure by the junior lienholder is an unauthorized transfer of the property in violation of the due-on-sale clause. In either case, the senior lender may then accelerate its loan and foreclose if full payment is not forthcoming. A buyer must either confirm that an existing lender's consent to the sale is unnecessary or obtain that consent. On due-on-sale and due-on-encumbrance clauses generally, see California Mortgages, Deeds of Trust, and Foreclosure Litigation §§8.8-8.23 (4th ed Cal CEB 2009).

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Source: Real Property/California Title Insurance Practice/5 Preliminary Reports and Commitments/§5.14 e. Leasehold Interests

§5.14 e. Leasehold Interests

If the title company discovers tenants in possession through a site inspection or learns of unrecorded leases by examining a recorded instrument that discloses an unrecorded lease (such as a memorandum of lease, a notice of nonresponsibility, or a financing statement), the preliminary report will list those matters as exceptions to coverage.

PRACTICE TIP: Theoretically, if a title company intends to issue an extended coverage policy, it will want to inspect the property. As a practical matter, inspections are only undertaken in high liability transactions or in transactions in which specific issues arise that could be resolved or clarified with an inspection. An inspection is usually required in construction loan situations to establish whether any work has begun that would affect the priority of the construction deed of trust. Sometimes, a title company will inspect the property even if a standard coverage policy will be issued if the proposed insured requests one or if the amount of coverage exceeds a given liability limit established by the title company. Often, however, because of the distance between the title plant and the subject property, inspections are subcontracted out.

The acceptability to the buyer of a leasehold exception largely depends on whether it refers to a current tenant. If the exception refers to an expired lease, the buyer will want the exception removed before close of escrow. The buyer should obtain and carefully review all existing leases. (The buyer must obtain copies of the leases from the seller; because parties rarely record entire leases, they are seldom available from the title company.) Buyer's counsel should ascertain whether the lease contains a right of first refusal to purchase the property that would be triggered by the current transaction. Similarly, counsel must evaluate the effect of any option to purchase. On leasehold interests generally, see Retail Leasing: Drafting and Negotiating the Lease (Cal CEB 2007); Office Leasing: Drafting and Negotiating the Lease (Cal CEB 1996); Ground Lease Practice (2d ed Cal CEB 2009).

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§5.15 (1) Subordination and Attornment Clauses

Lender's counsel will want to know whether a lease contains a subordination clause. Generally, a lender wants the ability to force subordination of any lease to its loan, thereby enabling the lender to eliminate the lease if it forecloses on its deed of trust. Note, however, that *Dover Mobile Estates v Fiber Form Prods.* (1990) 220 CA3d 1494, 270 CR 183, gives the tenant reciprocal termination rights when such subordinations exist. Lenders should carefully analyze the benefits in each lease rather than automatically insisting on subordination.

Under the holding of *Miscione v Barton Dev. Co.* (1997) 52 CA4th 1320, 61 CR2d 280, lenders should also consider the impact of attornment clauses. In this case, the court upheld the effect of an attornment provision of a lease otherwise junior to a foreclosed deed of trust. The attornment clause provided that the tenant would continue its tenancy following a foreclosure if the new landlord acquired the property and accepted the lease. Citing *Dover Mobile Estates v Fiber Form Prods, supra*, the tenant argued that the landlord had failed to accept the lease as it did not give the notice required by the subordination clause. The court rejected this argument and held that the subordination notice was not required. Rather, the landlord acquired the property through foreclosure and accepted the lease by notifying the tenant after the sale where to send the rent. The court distinguished *Dover* by noting that the *Dover* court did not discuss whether there was an attornment clause or what effect an attornment clause would have on the priority of the lease. Rather, the *Dover* court focused on the automatic subordination clause.

Lenders' counsel should also consider *Principal Mut. Life Ins. Co. v Vars, Pave, McCord & Freedman* (1998) 65 CA4th 1469, 77 CR2d 479. Like *Miscione, Principal* upheld the effect of an attornment provision in a junior lease as being enforceable by a lender on a foreclosure sale resulting in the lender's acquisition of leased property. In *Principal,* however, the court held that the lender could not unilaterally subordinate the lien of its deed of trust to a lease before the foreclosure by recording a subordination agreement signed only by the lender, because the lease did not provide for such subordination as did the lease in *Dover*. Unlike *Miscione,* the *Principal* court focused more on the contract terms and not a lien priority analysis in recognizing the effect of the attornment provision and its enforceability by the lender as a third-party beneficiary of the clause.

On subordination, nondisturbance, and attornment agreements, see Retail Leasing: Drafting and Negotiating the Lease, chap 44 (Cal CEB 2007); Office Leasing: Drafting and Negotiating the Lease, chap 28 (Cal CEB 1996).

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Source: Real Property/California Title Insurance Practice/5 Preliminary Reports and Commitments/§5.16 (2) Rent Concessions

§5.16 (2) Rent Concessions

Both buyers and lenders should scrutinize leases for rent concessions. These do not always occur at the inception of the lease and can have a significant effect on the value of the property owing to the impact of the concessions on the property's cash flow.

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§5.17 (3) Ground Leases

Ground leases present special problems to lenders. A lender who takes a ground lease interest as security for its loan wants to be able to foreclose its lien and still preserve the ground lease in effect. The lender will be concerned if any defaults are noncurable or if the cure periods are short. Thus, mortgagee protection provisions are vital. A buyer will want to review the financing provisions of a ground lease to see whether they contain mortgagee protection provisions or whether they allow the lessee to cause the lessor to pledge the fee title to the property as security for the deed of trust. For further discussion of the lender's concerns in ground leases, see Ground Lease Practice, chap 11 (2d ed Cal CEB 2009).

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§5.18 f. Tax Liens

The preliminary report will include exceptions for recorded federal and state tax liens for unpaid income, employment, estate or inheritance, and sales taxes. If a partnership owns the property and the liens derive from an individual partner's failure to pay income taxes, the liens do not attach to the property. A partner's interest in the partnership is personal property. For partnerships formed before January 1, 1997, effective until January 1, 1999, see former Corp C §15026; for partnerships formed after January 1, 1997, see Corp C §16502.

CAVEAT: Some title company attorneys report that the Internal Revenue Service sometimes takes the position that certain tax liens against an individual general partner, such as employment taxes, attach to partnership property, especially if the general partner contributed the property to the partnership. Both buyers and lenders typically require all tax liens (except for real property taxes not yet due and payable) to be removed on or before the close of escrow.

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Source: Real Property/California Title Insurance Practice/5 Preliminary Reports and Commitments/§5.19 g. Miscellaneous Exceptions

§5.19 g. Miscellaneous Exceptions

Other exceptions that may be found in a preliminary report include, but are not limited to:

- "The effect of [name of document]" exception. If the title company questions the effect of any document, they will list it and generally request additional information. For example, assume that Smith conveyed the property to Jones by grant deed and a title policy was issued to Jones. Then Jones conveys the property by grant deed to Brown but Brown does not obtain title insurance. Some title companies, concerned about the possibility of a forged deed, will show title vested in Jones and request Brown to provide additional evidence that the conveyance was valid.
- The Mello-Roos exception. This is a continuing lien securing the levy of special taxes under the Mello-Roos Community Facilities Act of 1982 (Govt C §§53311-53368.3).
- The *Gion-Dietz* exception. If the property is located near streams, beaches, wetlands, etc., the title company will usually include an exception for public access. See *Gion v City of Santa Cruz* (1970) 2 C3d 29, 84 CR 162; *Dietz v King* (1970) 2 C3d 29, 84 CR 162. However, see CC §1009, which provides that public use of private real property after its effective date (March 4, 1972) shall never ripen to confer vested rights to continue such use under the implied dedication doctrine unless a government entity expended public funds to improve or maintain the land for public use or the land lies within 1000 yards of coastal waters. See also *Friends of the Trails v Blasius* (2000) 78 CA4th 810, 93 CR2d 193 (CC §1009 in large part abrogates *Gion-Dietz* prospectively).
- Lis pendens, judgments, and attachments.
- Personal property taxes (Rev & T C §2189).

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§5.20 4. Notes

Following the typewritten exceptions, the preliminary report may include a section titled "Notes," which contains important information related to the property. This information might include a list of conditions to be met before closing, such as delivery of documents evidencing a seller's authority to act (see §§2.29-2.34), third party consents or approvals (such as governmental approval of a subdivision or court approval of a probate sale), releases and/or reconveyances, or a survey. If the title company is also the escrow holder, the escrow holder may also add information for the insured, such as an explanation of the effect of the good funds law. Ins C §12413.1.

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Source: Real Property/California Title Insurance Practice/5 Preliminary Reports and Commitments/§5.21 C. Negotiating Exceptions

§5.21 C. Negotiating Exceptions

Title insurance is a matter of contract and, as such, the coverage terms are negotiable. The title insurer, in the exercise of its judgment, may fix the terms on which it will insure title. *Contini v Western Title Ins. Co.* (1974) 40 CA3d 536, 115 CR 257.

As a result, the exceptions shown in the policy are not always those of record. Whether a particular exception will appear in the title insurance policy is always open to negotiation. In response to a request to delete an exception to coverage, the title company may either refuse to delete it, narrow the language of the exception, or issue an endorsement insuring over the defect, thereby assuming a risk that the defect may cause a loss sometime in the future.

EXAMPLE: The initial description of an exception may be overly broad, and narrowing the description, instead of deleting it, will be an appropriate or a compromise solution. For instance, an exception may be made for any matters that would be shown by a survey. If a survey is made, the title company should be willing to narrow the exception to the specific matters shown by the survey.

If the title company refuses to remove an exception, the buyer or the lender can either accept the exception or require the seller or the borrower to remove it from the record. See §§5.39-5.44 for discussion of methods of handling a title defect; see §§2.22-2.27 on negotiating coverage.

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§5.22 1. Statutory Limitations on Enforceability of Ancient Instruments

In certain instances, title companies will list "ancient" documents on the preliminary report for some years past their expiration date. Thus, some exceptions to title that appear in a preliminary report may have expired because of their terms or the passage of time. A buyer or a lender may be able to persuade a title company to delete these exceptions.

PRACTICE TIP: A title company may be more willing to delete such exceptions if an ALTA lender's policy is being issued, because the risk of loss to the title company is perceived to be less for an ALTA lender's policy than for an owner's policy. This perception is attributed to various factors. Sometimes the lender must go through more steps before it can claim a loss on the policy. See §§6.74, 8.42-8.45. Also, the loan-to-value ratio may provide a sufficient equity cushion to absorb any loss before the lender incurs a loss.

Beginning January 1, 1983, ancient deeds of trust and mortgages began to expire and to become unenforceable. See generally CC §§880.020-880.370 and, more specifically, CC §§882.020-882.040. The expiration date depends on whether the maturity date can be discerned from the recorded evidence of indebtedness. If the maturity date can be confirmed, the lien expires 10 years after that date. If the maturity date cannot be confirmed, the lien expires 60 years after recordation of the instrument. CC §882.020. Recorded documents rarely state a maturity date. A reference to an unrecorded document that states a maturity date in a recorded instrument is insufficient to make the maturity date "ascertainable from the record." *Miller v Provost* (1994) 26 CA4th 1703, 33 CR2d 288. The lienholder may extend the lien period for 10 years by recording the statutory form for notice of intention to preserve an interest (CC §880.340) before the lien is extinguished (CC §882.020).

CAVEAT: An insurer may be unwilling to delete an ancient document as an exception solely on the basis of the statutes cited above. As noted in dicta by the court in *Walton v City of Red Bluff* (1991) 2 CA4th 117, 3 CR2d 275, the constitutionality of those statutes has not been litigated. Therefore, a title company may require an indemnity agreement before it will delete the exception.

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Source: Real Property/California Title Insurance Practice/5 Preliminary Reports and Commitments/§5.23 2. Termination of Unexercised Options, Powers of Termination, and Unperformed Contracts for Sale of Real Property

§5.23 2. Termination of Unexercised Options, Powers of Termination, and Unperformed Contracts for Sale of Real Property

Provisions that generally apply to expiration of ancient mortgages and deeds of trust (see §5.22) also apply to terminate unexercised options, powers of termination, and unperformed contracts for the sale of real property. See CC §§880.020-880.370, 884.010-886.050. Beginning January 1, 1983, a recorded option is extinguished of record six months after the option expires under its own terms or, if the option does not contain an expiration date, six months after it was recorded. The option may be extended by conveyance, contract, or other instrument that gives notice of exercise or extension of time. CC §884.010. On expiration, the recorded option no longer creates or gives constructive notice of the existence of the option. CC §884.020.

PRACTICE TIP: This expiration of constructive notice does not affect the agreement between the parties. Thus, if an option agreement provides for a one-year termination but the recorded memorandum is silent as to a termination date, the agreement will remain in effect between the parties and between the parties and anyone with actual notice of the termination date. However, the constructive notice imparted by the recorded memorandum of option will expire in the six-month period. The optionee's attorney should confirm that the memorandum of option states the expiration date. Failing that, the optionee may still preserve its interest under the recorded memorandum of option if, before it expires, the optionee records a notice of intent to preserve the interest under CC §880.310.

Powers of termination, including right of reentry, right of reverter, right of repossession for breach of condition subsequent, and similar terms are defined in CC §885.010. Powers of termination expire if they become obsolete, which occurs when (CC §885.040(b)):

- The restriction is of no actual and substantial benefit to the holder of the power;
- Enforcement would not result in the purpose of the restriction; or
- It would be inequitable to enforce the restriction because of changed circumstances.

No power of termination arising from a grant by a natural person to a public entity or charity will expire during the life of the grantor. CC §885.040(c). Powers of termination also expire of record 30 years after the instrument evidencing the power was recorded, unless they are otherwise terminated or extended. CC §885.030.

CAVEAT: An insurer may be unwilling to delete these recorded documents as exceptions solely on the basis of the statutes cited in the foregoing paragraph. See §5.22. In considering whether to delete these documents as exceptions, the title company will inquire into the nature of the power of termination, the nature of the event or condition that would trigger exercise of the power, and the present circumstances of the property and its uses. A title company may require an indemnity agreement before it will delete the exception.

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Source: Real Property/California Title Insurance Practice/5 Preliminary Reports and Commitments/§5.24 3. Extinguishing Contracts for Sale of Real Property

§5.24 3. Extinguishing Contracts for Sale of Real Property

The passage of time may also extinguish a contract for the sale of real property (including a memorandum of the contract) that requires conveyance of title within one year after the date of the contract. See CC §§880.020-880.370, 886.010-886.050. Recorded contracts of sale expire of record five years after the date provided for conveyance of title or, if no date is provided, five years after the last date specified for satisfaction of the conditions stated in the contract. The expiration date may be extended for five years by recording an extension before the contract expires. CC §886.030.

CAVEAT: An insurer may be unwilling to delete a recorded contract or memorandum of contract as an exception solely on the basis of the statutes cited above because their constitutionality has not been litigated. See §5.22. The title company may require an indemnity agreement before it will delete the exception.

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D. Liability of Preparer of Preliminary Report

§5.25 1. Abstracts of Title Distinguished

The preliminary report and the abstract of title are very different reports. They contain different information, and the liability of the preparers differs significantly. *Siegel v Fidelity Nat'l Title Ins. Co.* (1996) 46 CA4th 1181, 54 CR2d 84. A title abstractor searches all title records pertinent to a parcel of real property and reports all matters affecting title. *Viotti v Giomi* (1964) 230 CA2d 730, 41 CR 345; *Hawkins v Oakland Title Ins. & Guar. Co.* (1958) 165 CA2d 116, 331 P2d 742. The abstractor compiles a summary, known as an abstract, which reports on the condition of title. On title records, see chap 4.

An abstract of title is a written representation of all recorded instruments. It imparts constructive notice about the title to a particular piece of real property. Ins C §12340.10. Abstracts are created by specialized title record examination companies (generally not title insurance companies in California). Because all recorded documents must be read, preparation of an abstract can take months and be very costly. The abstract usually starts at the source of title, such as the patent or land grant, unless another date is specified by the recipient. The information in the abstract alone is not generally useful to a client. It requires an attorney to examine the abstract and render an opinion on the condition of title, which is not customarily done in California. Because of the cost of the abstract in both dollars and time, it is impractical in most transactions. It may be used in litigation if an attorney wishes to have a complete record of the property during a specific time period.

PRACTICE TIP: Although title companies do not provide abstracts, they do provide other reports and guaranties that supply property information when insurance is not required. See chap 9 on guaranties.

The abstractor's duty is to search the public records with the degree of professional skill and care commensurate with that profession, and to report all matters that could affect the client's interests and that are discoverable by exercising reasonable diligence. *Contini v Western Title Ins. Co.* (1974) 40 CA3d 536, 115 CR 257. The abstract delivered to the purchaser must contain a full summary of all matters in the chain of title. *Smith v Taylor* (1890) 82 C 533, 23 P 217; *Viotti v Giomi, supra*. An abstract of title does not, however, express an opinion about the title of the property. See Rooney, Attorney's Guide to Title Insurance §2.21 (1987). See also Ins C §12340.10.

Two causes of action may arise against an abstractor. One is for breach of contract for failure to conduct a complete search; the other is for negligent misrepresentation based on incompetent information inducing the recipient of the abstract to act. *Lattin v Gillette* (1892) 95 C 317, 30 P 545. On causes of action against abstractors generally, see §§11.38-11.41.

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2. Liability of Preparer of Preliminary Report

§5.26 a. Pre-1982 Preliminary Reports Treated as Abstracts

Abstracts are seldom issued in California. Unlike an abstract of title, a preliminary report is not intended to be a full summary of all matters in the chain of title. Rather, it is a report of the matters affecting title, as of the date of the report, against which the issuer is not willing to insure. Despite these differences, courts have held that pre-1982 preliminary reports were equivalent to abstracts of title and carried liability for errors and omissions. *Hardy v Admiral Oil Co.* (1961) 56 C2d 836, 841, 16 CR 894; *Hawkins v Oakland Title Ins. & Guar. Co.* (1958) 165 CA2d 116, 331 P2d 742; *J. H. Trisdale, Inc. v Shasta County Title Co.* (1956) 146 CA2d 831, 837, 304 P2d 832. Courts also held that the issuer of a preliminary report could be liable for negligence if it omitted a material matter. See *Garton v Title Ins. & Trust Co.* (1980) 106 CA3d 365, 165 CR 449; *Jarchow v Transamerica Title Ins. Co.* (1975) 48 CA3d 917, 122 CR 470, overruled on other grounds in 184 CA3d at 434, both holding that a title insurer's obligations in performing a title search are identical to those of a title abstractor. On actions under pre-1982 preliminary reports, see §11.43.

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§5.27 b. Post-1981 Preliminary Reports Treated as Offers to Insure

The legislature overruled the cases holding that preliminary reports are equivalent to abstracts of title by adopting Ins C §§12340.10-12340.11, operative January 1, 1982, which clearly distinguish the liability of the issuer of a preliminary report (or of a commitment or binder) from that of the preparer of an abstract of title. (On commitments, see §§5.31-5.38; on binders, see §§3.20-3.22.) An abstract of title is not a title policy and, conversely, a preliminary report is not an abstract of title. Further, the preliminary report may not be construed as a representation of the condition of title to real property. It is only an offer of the terms under which a policy of title insurance will be issued. Therefore, none of the rights, responsibilities, or duties that apply to the preparer or issuer of an abstract of title apply to the preparer or issuer of a preliminary report.

This statute applies prospectively only. Thus, the California Supreme Court held in *White v Western Title Ins. Co.* (1985) 40 C3d 870, 883, 221 CR 509, that "the failure of a title company to note an encumbrance of record [on a preliminary report] is prima facie negligent." It further held that negligence is an available cause of action for preliminary reports issued before January 1, 1982. 40 C3d at 884.

This question of title company liability for preliminary reports continues to be an issue. In *Siegel v Fidelity Nat'l Title Ins. Co.* (1996) 46 CA4th 1181, 54 CR2d 84, the court, relying on Ins C §§12340.10-12340.11, reiterated the general rule of nonliability, noting that preliminary reports are prepared solely for the purpose of limiting the insurer's own risk. The court held that a party who does not purchase title insurance may not rely on a title insurer to protect the party's interests or to disclose all detrimental information in the records. On causes of action against issuers of preliminary reports generally, see §§11.42-11.44. See also §13.4.

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§5.28 c. Title Insurer Is Not Insured's Agent for Purposes of Constructive Notice

The title insurer is not an agent of the purchaser. If the title insurer learns of a lien or an encumbrance but does not include it as an exception to coverage, the insured will not be deemed to have notice of it. See *Rice v Taylor* (1934) 220 C 629, 32 P2d 381; *Rice v Capitol Trailer Sales* (1966) 244 CA2d 690, 53 CR 384. Nor does the holder of a lien have a cause of action against the title insurer for failing to disclose the lien to the buyer. See *Stagen v Stewart-West Coast Title Co.* (1983) 149 CA3d 114, 196 CR 732, which held that a person who recorded a lis pendens has no cause of action against the title insurer for its failure to disclose the lis pendens to the buyer. The insurer could decide to assume the risk of the pending action.

EXAMPLE: Owing to its system of reclassifying recorded documents by geographic location, a title company may find an instrument that is not in the chain of title (a "wild deed"). Because recordation of a wild deed does not impart constructive notice to subsequent purchasers in California (*Dobbins v Economic Gas Co.* (1920) 182 C 616, 189 P 1073; *Stearns v Title Ins. & Trust Co.* (1971) 18 CA3d 162, 95 CR 682), the purchaser (or lender) will not be subject to it unless he or she receives actual notice of it, either directly or through a preliminary report (*Parkside Realty Co. v MacDonald* (1913) 166 C 426, 137 P 21).

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§5.29 3. 1995, 2004, and 2006 Preliminary Report Forms

The CLTA promulgated a form of preliminary report in 1995 (see App C). New versions were adopted in 2004 (see App D) and 2006 (see App E). Even the name of the reports, which eliminates the word "title," is intended to make it clear that they are only a statement of the conditions under which the insurer will issue a title insurance policy. These preliminary reports contain the exclusions and preprinted exceptions to coverage to be found in the particular policy to be issued. The disclosure of the exclusions and exceptions to coverage should preclude misunderstandings between the insured and the insurer as to the nature and extent of the coverage.

These forms also contain the following language required by Ins C §12414.30 to appear in bold print on the front of any preliminary report:

> Please read the exceptions shown or referred to below and the exceptions and exclusions set forth in Exhibit A of this report carefully. The exceptions and exclusions are meant to provide you with notice of matters which are not covered under the terms of the title insurance policy and should be carefully considered.
>
> It is important to note that this preliminary report is not a written representation as to the condition of title and may not list all liens, defects, and encumbrances affecting title to the land.

To reinforce this limit on liability, the form of preliminary report used by most title insurers in California states on its first page that it is "issued solely for the purpose of facilitating the issuance of a policy of title insurance and no liability is assumed hereby." The 1995, 2004, and 2006 CLTA preliminary report forms all contain this statement.

Despite the title companies' clear limitations on liability, some real estate investors and lenders use the preliminary report as if it were a cheap "abstract of title." They order a preliminary report at the inception of the transaction, assume that it represents the state of title to the property in question, and proceed to close the transaction without purchasing title insurance. Often, they do not even obtain copies of the exceptions summarized in the report. Attorneys should strongly caution clients against this practice. The summaries may inadequately describe title problems that a review of the underlying documents would reveal. Attorneys should also advise clients that the preliminary report may omit certain exceptions to title. The omission may be inadvertent or it may arise from a deliberate title company underwriting decision.

Further, attorneys should inform their clients that, even if the preliminary report is accurate, it would not contain any liens and encumbrances that arise after the "as of date" of the preliminary report, unless the report is updated. Usually, the insurer issues a single preliminary report before issuing the title insurance policy. Sometimes, however, amended or supplemental reports are issued as information is evaluated (*e.g.*, when a survey is obtained or when the seller provides the title company with further information on identity, which reveals tax liens against the property) or underwriting considerations change. If a long time elapses between the date of the preliminary report and the closing date, particularly if the transaction has been dormant, the insured's attorney may want to order an updated preliminary report to confirm that no new liens or encumbrances have been recorded.

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§5.30 E. Issuer's Duty to Issue Title Policy

The author has found only one California decision that directly addresses the question of whether an insurance company has a duty to issue a title policy. In *Quelimane Co. v Stewart Title Guar. Co.* (1998) 19 C4th 26, 77 CR2d 709, the supreme court held that a real property purchaser who had been denied title insurance coverage for a tax-defaulted property had stated a cause of action for unfair competition and intentional interference with contractual relations under the circumstances presented in the case, but the court continued to maintain that an insured does not have a duty to do business with or issue a policy of title insurance to any applicant for insurance. The court left to the legislature the issue of whether title companies should be required to issue title policies in certain types of transactions.

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II. COMMITMENTS

§5.31 A. Purpose

A commitment is an agreement by a title insurance company to issue a policy in favor of the proposed insured at the time the transaction closes. It does not represent the state of title. Ins C §12340.11. The 1982 ALTA commitment form has been the standard form used for some time; however, in 2006, ALTA issued two new commitment forms, the 2006 ALTA Commitment Form and the 2006 ALTA Plain Language Commitment Form. A 2008 Short Form Commitment is also available for use with an ALTA Short Form Residential Loan Policy (6/16/07) or an ALTA Short Form Expanded Coverage Residential Loan Policy (1/1/08). This Short Form Commitment incorporates by reference the terms and conditions of the 2006 ALTA Plain Language Commitment. In addition, some title companies prepare their own forms. See App F for the 1982 ALTA commitment form, and App G for the 2006 ALTA commitment form.

PRACTICE TIP: Counsel should carefully review the requirements section of the commitment for overly broad or generic requirements that diminish the advantage of obtaining a commitment. These requirements can be modified by negotiating with the title company.

Commitments are requested in lieu of a preliminary report. In most states, only commitments are offered by title companies. In California, although commitments are seldom issued in residential transactions, they are common in commercial transactions, especially if counsel or the institutional client is from out of state. The usefulness of the commitment, if prepared correctly, is that the requirements section provide a valuable roadmap of what needs to be done to obtain the desired insurance.

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§5.32 B. Contents

The 1982 and 2006 ALTA commitment forms contain no insuring clauses but they do create a contract between the title company and the proposed insured. The commitment sets forth the terms on which the title company will issue a title policy. Although a sample form of the policy is not part of the commitment, it is good practice for the prospective insured to request a form of the policy to be issued in order to avoid any inconsistencies between the commitment and the ultimate policy.

The commitment contains the following sections:

- Agreement to issue policy (see §5.33);
- Information on the insured and the policy to be issued (Schedule A) (see §5.34);
- Requirements to be met by the insured (Schedule B, Section I) (see §5.35);
- Exceptions to coverage (Schedule B, Section II) (see §5.35); and
- Conditions to the insurer's issuance of the title policy (see §5.36).

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§5.33 1. Agreement to Issue Policy

In the agreement to issue policy section of both the 1982 and the 2006 ALTA commitment forms, the title company agrees to issue a policy under the terms of the commitment if the requirements stated in the commitment are met within a certain number of days or months after its effective date, known as the commitment date. Unlike a preliminary report, if an insurer issues a commitment, it is obligated to furnish a title policy if the buyer or the lender complies with the conditions of the commitment. The title company's obligations under the commitment end on the commitment date or the date the title insurance policy is issued, whichever occurs first.

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Source: Real Property/California Title Insurance Practice/5 Preliminary Reports and Commitments/§5.34 2. Identifying Information

§5.34 2. Identifying Information

Schedule A of the 1982 and 2006 ALTA commitment forms provides the following information:

- The commitment or effective date;
- The type of policy to be issued;
- The policy amount;
- The estate or interest to be insured;
- How title is vested on the commitment date; and
- A legal description of the property.

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§5.35 3. Requirements and Exceptions

Section 1 (or I) of Schedule B of the 2006 ALTA commitment form (see App G) leaves it to the insurer to insert regional or standard state requirements. In contrast, Section I of Schedule B of the 1982 ALTA commitment form (see App F) and the 2006 ALTA "Plain Language" commitment form (also included in App G) lists the requirements that the proposed insured must fulfill. The insured must:

- Pay the agreed amounts for the interest in the land or the mortgage to be insured;
- Pay the required premiums and other charges for the policy;
- Sign, record, and deliver documents satisfactory to the title company for creation of the interest in the land or the mortgage being insured; and
- Disclose in writing to the title company any party not referred to in the commitment who will obtain an interest in or make a loan on the land.

Under any of these three versions, additional requirements may be added, depending on the nature of the transaction and the specific title issues involved.

EXAMPLE: Additional requirements may include a survey, government approval of a subdivision, court approval of a probate sale, the release and/or reconveyance of a lien, or proof of authority to act. On authorizing documents, see §§2.29-2.34.

Under all three of these versions, Part II of Schedule B is left blank for the insurer to insert the exceptions (both preprinted and typewritten) that will be shown on the issued title report. See §§5.8-5.24, 6.50-6.57 for further discussion of exceptions.

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§5.36 4. Conditions

The 1982 and 2006 ALTA commitment forms also contain a set of conditions that apply to the insurer's obligation to issue a policy. The conditions of coverage limit the issuing company's liability under the commitment to any actual loss suffered by the insured on undertaking in good faith to comply with the requirements of the commitment, to eliminate exceptions shown in Schedule B before the title policy is issued, and to acquire or create the estate or the interest covered by the commitment. The issuing company retains the right to amend the schedule of exceptions to show any new defects, liens, or encumbrances that are recorded for the first time or created or attached between the commitment date and the date on which the requirements are met.

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§5.37 C. Liability of Issuer of Commitment

Like the issuer of a preliminary report, the issuer of a commitment is not liable for failure to note an encumbrance of record. Ins C §§12340.10-12340.11. Although the author has found no cases on the issue of the title company's duty to issue a policy after a commitment has been issued, the insured should be able to state a cause of action for breach of contract if the title company fails to issue a title policy after the prospective insured has met the requirements and conditions set forth in the commitment. If the commitment is amended to add any defects, liens, or encumbrances that existed on the commitment date, the title company will be liable if, in relying on the commitment, the insured acted in good faith and incurred a loss as a result of such amendment. The scope of that liability is limited by the terms of the commitment.

PRACTICE TIP: Commitments may or may not be issued for a fee. If a fee is paid before a claim is discovered, the title company is contractually bound to issue the title policy as described in the commitment. Some attorneys believe that if a fee has not been paid there may be a problem in stating a cause of action for breach of contract because of the lack of consideration. This problem can often be overcome by showing a detrimental reliance by the proposed insured, particularly if that party fulfilled the conditions of the commitment. Counsel would especially want to consider paying a fee for the commitment (to be applied against the premium of the title policy) if the insured must make a nonrefundable deposit. (On prohibitions of inducements to placement or referral of title business, see Ins C §§12404-12413.5, 12418.4.)

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§5.38 D. Attorney's Duties on Commitment

On receipt of the title insurance policy, the insured's attorney should review it carefully to make sure that it is consistent with the terms of the commitment and any escrow instructions issued in connection with the policy. For further discussion of title instructions, see §§10.13-10.18.

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§5.39 III. HANDLING TITLE DEFECTS

When the title insurer is unwilling to remove an exception, and it is not practicable or possible for the seller or borrower to clear objectionable defects before closing, several courses of action are available to the parties to complete the transaction. See §§5.40-5.44.

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A. Indemnity Agreements

§5.40 1. Indemnification of Buyer

The buyer can obtain an indemnity agreement from the seller in which the seller agrees to reimburse the buyer for the cost of clearing title or for any loss incurred by existence of the defect. The agreement can be unsecured, but it is usually better practice to have it secured, either by funds held in an escrow account or by other assets of the seller. On funds held in a holdback account, see §5.42. The lien, defect, or encumbrance will be shown as an exception to coverage on the title policy, but the title company may agree to amend the policy by endorsement once the defect, lien, or encumbrance is cleared.

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§5.41 2. Indemnification of Insurer

As a condition to insuring despite a defect, the title company may require the seller to give the company an indemnity, or require one of the parties to the transaction to deposit funds with the title company in the sum estimated to be necessary to cure the title defect. These funds will be held by the title company (not the escrow company, if different from the title company) until they are used to cure the defect. If the indemnifying party fails to cure the defect, the title company may attempt to do so.

NOTE: Sometimes the seller or the borrower will enter into an indemnity agreement with the title company to insure over a defect, lien, or encumbrance without disclosing this fact to the prospective buyer or the lender. This happens most commonly with mechanics' liens, federal and state tax liens, unconveyed mortgages, and spousal and child support liens. Counsel for sellers, borrowers, or title companies knowledgeable about such nondisclosed indemnity agreements should advise their clients to carefully consider the consequences if the indemnifying party fails to comply with the indemnification and the insured party suffers a loss. Such parties may be subject to claims of fraud or material nondisclosure.

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Source: Real Property/California Title Insurance Practice/5 Preliminary Reports and Commitments/§5.42 B. Holdback Agreement

§5.42 B. Holdback Agreement

Another approach to handling title defects is for the parties to deposit into an account with the title company a portion of the sums due the seller at closing. The title company then uses these funds to clear a specific title defect that can be cured by the payment of money. The parties instruct the title company to release to the seller any sums not used to remove the defect and to issue an endorsement to the title policy confirming that removal.

PRACTICE TIP: If funds are deposited into an escrow account, the title company will want to make sure that the issues appear to be resolvable, the instructions to release funds are clear, and, most of all, that release of funds requires mutual, not unilateral, instructions.

As an alternative to a holdback, the title company may accept a bond posted by the seller. Bonds, however, are of use in only limited situations, such as (1) removal of mechanics' liens (CC §3143), (2) releases of deeds of trust (CC §2941.7), and (3) lost or destroyed notes (CC §3415). Bonds are issued by casualty carriers and require annual premium payments plus posting of security. The availability of the bonds depends on the subject matter of the bond, and the premium will be adjusted to correspond with the risk.

PRACTICE TIP: Statutory bonds, such as CC §3143 mechanics' lien bonds, can be expensive and the cost is nonrecoverable. If the client has cash available to deposit with the title company pending resolution of the disputed liens, and if the title company is willing to establish a holdback account, the client may save premiums and obtain the benefit of accrued interest by depositing the money with the title company. There are two disadvantages to this solution. The first is the potential effect on the client's cash flow and asset allocation because title companies generally require 1.5 times the gross amount of the subject dispute, which in turn is usually defined as the face amount of the lien or the demand in the complaint. The second is that, if the money is in a holdback account, the title remains subject to the lien so that, if a legal action is filed, the insured will be named in the action. If a bond is used, the lien is removed from title and the insured is not subject to being named in the action.

CAVEAT: Whenever funds are to be placed in escrow to deal with a title defect, the implications of bankruptcy law must be considered. *In re Rosenshein* (SD NY 1992) 136 BR 368 involved a construction lender who advanced funds to the borrower to deposit in escrow to support an indemnity agreement given by the borrower. The borrower filed for protection under Chapter 11 (11 USC §541(a)). The issue arose as to whether the borrower retained an ownership interest in the escrowed funds, which would make them the property of the debtor's estate. The bankruptcy court held under New York law that the borrower did have a sufficient interest in the funds to make them the property of the debtor's estate.

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§5.43 C. Endorsements and Extended Coverage

A third approach to handling title defects is to secure, at the seller's expense, an endorsement to the buyer's title policy that adds coverage against loss caused by the defect. On owner's endorsements, see §§7.64-7.103. On lender's endorsements, see §§8.50-8.118. An ALTA owner's policy may provide the same result, with the seller paying the cost in excess of the standard CLTA policy. The availability of this approach depends on the nature and scope of the defect.

PRACTICE TIP: In dealing with a title defect, the insured's first choice should be to try to obtain an endorsement because it essentially shifts the risk to the title company. The insured should always obtain and review the language of the endorsement and negotiate, if necessary, for the desired coverage. A holdback agreement is second best, as long as the cost of curing the defect is certain. If it is not, an indemnity may be better. In all cases, attorneys should advise their clients about the serious risks of accepting an unsecured indemnity. The indemnitor's financial strength is key, and its bankruptcy could destroy an indemnity.

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§5.44 D. Extension of Time

If none of these solutions can be implemented, the buyer can elect to give the seller a reasonable time in which to clear title and furnish marketable title to the buyer.

PRACTICE TIP: This solution is generally not attractive to the buyer, which may lose its financing from the delay or may suffer other financial losses from being unable to complete the contract on time. If financial costs outweigh the benefits of waiting to see whether the seller can clear the exception, the buyer, if permitted by the purchase and sale agreement, may cancel the contract and get the deposit back. *Leiter v Handelsmant* (1954) 125 CA2d 243, 270 P2d 563.

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Structure and Coverage of Title Insurance Policy Forms

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I. OVERVIEW

A. Scope of Title Insurance Coverage

§6.1 1. Definition of "Insurance"

The word "insurance" means an agreement to indemnify against loss or damage arising from an insured event occurring within the prescribed time of the policy. Most forms of insurance protect the insured against potential damage from a prospective event, *e.g.,* a fire that burns a building or a driver who injures a pedestrian. Title insurance does not. Subject to the conditions and stipulations of the policy, it covers loss or damage caused by a matter in existence on the date of the policy that affects the title to the property and that was not excluded or excepted from the policy coverage. Title insurance does not guarantee that no title problem exists.

For discussion of exclusions, see §§6.34-6.48. On exceptions, see §§6.50-6.57. On conditions and stipulations, see §§6.58-6.84.

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§6.2 2. Title Policy Does Not Represent State of Title

Subject to the terms and limitations of the policy, a title claim is paid if, on the date on which the policy was issued, either the problem or the matter that created the problem was already in existence. The title policy indemnifies against losses and defense costs incurred by the insured as a result of a defect, lien, or encumbrance that is not excluded or excepted from coverage. *Smith v Commonwealth Land Title Ins. Co.* (1986) 177 CA3d 625, 223 CR 339.

PRACTICE TIP: An abstract of title contains representations regarding the condition of title. The abstractor has a duty to disclose all matters in the public records. The title insurance policy does not contain a representation regarding the state of title. The list of exceptions in the policy may not be a complete list of all items found in the public records. In reviewing the title records, the title insurance company makes a number of judgments on which items will be listed as exceptions and which will not. If the title insurance company believes that an item poses a minimal risk, that item may not be listed in the policy. On abstracts, see §5.25. On search of the public records, see chap 4. See also §13.4.

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§6.3 3. Insuring Over Known Risks

Title insurers may make underwriting decisions to insure over known risks. In fact, every title insurance policy in California has a variety of known risks that have been neither disclosed nor insured over because all recorded documents remain in the recorder's office in perpetuity. For instance, the recording of a deed of full reconveyance does not remove the deed of trust from the county records. Rather, an effective deed of reconveyance eliminates the lien of the deed of trust as a matter of law. The title insurer reviews the recorded documents and determines which of them to take exception to in its title insurance policy.

PRACTICE TIP: If a title company is not willing to write over a matter based simply on its examination of the public records, it may be willing to do so if an indemnity is provided. In this case, the insured obtains a CLTA 110.7 endorsement against loss by reason of attempted enforcement of the matter. This approach eliminates claims of nondisclosure such as those brought in *White v Western Title Ins. Co.* (1985) 40 C3d 870, 221 CR 509, and *Moe v Transamerica Title Ins. Co.* (1971) 21 CA3d 289, 98 CR 547.

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§6.4 4. Additional Coverage

A great deal of additional coverage is available by endorsements to the policy. For instance, endorsements can provide coverage for covenants or easements on dominant or servient tenements, unusual loan issues, access problems, options, or similar issues or problems.

For discussion of endorsements for owner's policies, see chap 7. On endorsements for lender's polices, see chap 8.

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§6.5 B. CLTA and ALTA Title Insurance Policy Forms

Title insurance companies offer a variety of insurance policies to meet the requirements of various real estate transactions. Because specific provisions of title insurance polices are not regulated by statute or by the Insurance Commissioner, the title insurer in California can determine conditions on which it is willing to issue its policies and can establish exceptions to its policy coverage. See *Overholtzer v Northern Counties Title Ins. Co.* (1953) 116 CA2d 113, 253 P2d 116. To a great extent, however, the title industry has standardized provisions of title policies through the California Land Title Association (CLTA) and the American Land Title Association (ALTA), which develop and publish the most widely used forms. Each title insurer files with the Insurance Commissioner any policy form it intends to use on a regular basis. See Ins C §12401.1.

PRACTICE TIP: The California Land Title Association sells a looseleaf or CD-ROM version of a policy and endorsement forms book, which is supplemented periodically. See Directory. This book conforms to the master file of generally used CLTA and ALTA forms on file with the California Department of Insurance. Some individual title companies also sell (or provide free of cost) similar books or CD-ROMs.

Until recently, the policy forms used most widely by title companies in California have been the CLTA 1990 standard coverage policy (see App H) and the ALTA 1992 extended coverage lender's policy (see App I). ALTA also publishes the 1992 ALTA owner's policy (see App K), which has been used either as an extended coverage policy or as a standard coverage policy by adding certain preprinted exceptions referred to as standard exceptions or as the "Western Regional Exceptions." In 2006, ALTA issued new versions of the owner's and lender's policies (see Apps J and L).

On Western Regional Exceptions, see §§6.8, 6.53. The ALTA residential (plain language) policy is often used in standard residential subdivisions. See §§7.36-7.49. Certain specialized ALTA forms are used less frequently by California practitioners. See §§6.12-6.17, 7.50-7.63, 8.34-8.39.

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§6.6 1. Standard and Extended Coverage Policies

Standard coverage policies (frequently used in residential and small commercial acquisitions, and in noninstitutional lending transactions) contain standard preprinted exceptions from coverage. A standard coverage policy does not require a survey or an inspection of the property. On standard coverage policies, see §§6.7, 6.51, 6.53. On surveys, see §§4.30-4.34.

Extended coverage policies, which are generally required by institutional lenders and many commercial buyers, do not contain standard, preprinted exceptions from coverage. Because they cover matters that would give inquiry notice (*e.g.,* tenants in possession, encroachments), the title company may require—at least for owner's policies—a survey, an inspection, or both. On extended coverage lender's policy, see §6.8. On extended coverage owner's policy, see §§6.10, 6.54.

PRACTICE TIP: Although the extended coverage policy is more expensive than the standard coverage policy (primarily because of the cost of the survey, if required by the title company or by a lender), the cost differential may be worth the expense for the additional coverage. If an insured is seeking indemnity under a standard coverage policy for a risk that would have been covered under an extended coverage policy, the courts may deny coverage because the insured could have obtained the coverage by simply purchasing it. See *White v Western Title Ins. Co.* (1985) 40 C3d 870, 221 CR 509; *Contini v Western Title Ins. Co.* (1974) 40 CA3d 536, 115 CR 257.

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2. Most Commonly Used Policies

§6.7 a. CLTA Standard Coverage Policy

The 1990 CLTA standard coverage policy, often referred to as a record title policy, is a joint protection policy that can be used for either (1) an owner or a lender individually or (2) an owner and a lender jointly. Buyers and financing sellers (who take back a purchase money note secured by a deed of trust as part of the sales price) customarily use this policy. One policy is issued that insures both the buyer and the lender.

In general, policy coverage extends only to defects ascertainable by an inspection of public records and certain narrowly circumscribed off-record risks that are not readily ascertainable from the records. *Barczewski v Commonwealth Land Title Ins. Co.* (1989) 210 CA3d 406, 258 CR 386. For the CLTA standard coverage policy form, see App H. (The same result could be reached by issuing two separate policies: a standard coverage owner's policy to the buyer and a standard coverage lender's policy to the lender.) On public records, see chap 4. On record title policies, see §7.22.

The most recent version of the CLTA standard coverage policy, issued in 1990, is similar to its predecessor except that it contains a "creditors' rights exclusion." On creditors' rights exclusions, see §§6.48, 6.88, 7.18-7.20, 8.32, 11.78.

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§6.7A b. CLTA Homeowner's Policy

The CLTA adopted a broad new form of title policy for homeowners in June 1998, called the Homeowner's Policy of Title Insurance. It updated these forms in October 2003 and January 2008. Although similar to the ALTA residential policy in their use of plain language, these policies provide much additional coverage. They are the best and most complete standard policies available to individuals who own a residence.

The policies add coverage that was previously available only by endorsement as well as coverage that was not previously available. A most unusual feature in the context of title insurance is coverage for certain post-policy matters.

The recent trend of offering expanded coverage to residential owners started in 1997 when First American Title Insurance Company began offering its Eagle form of the ALTA residential policy with enhanced coverage. The CLTA homeowner's policies have incorporated all of the new coverage added by title companies in 1997 and provide additional coverage as well. The typical premium is 10 percent above the usual owner's policy rate. This additional premium provides post-policy coverage for forgeries and construction by a third party of a structure encroaching onto the insured's land. It also provides continued coverage after a transfer of title to a trustee of a trust in which the insured was the settlor or trustor. See §§7.49A-7.49J.

The ALTA adopted the same policy forms. For the 1998, 2003, and 2008 CLTA/ALTA homeowner's policy forms, see App O.

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c. ALTA Loan Policy

§6.8 (1) Extended Coverage Policy

The ALTA loan policy (ALTA lender's policy) is designed to be used as extended coverage policy to protect lenders from loss of their security interest in property as a result of defects in title. It affords additional coverage for certain risks not insured by the CLTA policy. Because the insured lender often is not in a position to inspect the property or to make inquiries of any parties in possession, an ALTA lender's policy provides additional coverage necessary to protect the lender's interest, including coverage for losses arising from certain defects, liens, and encumbrances that are not part of the public records. By adding certain preprinted exceptions, known as the Western Regional Exceptions, an ALTA lender's policy can also be used as a standard coverage policy. See also §§6.5, 6.53.

PRACTICE TIP: As a condition to making a loan secured by real property, most institutional lenders require the borrower to obtain an ALTA lender's policy naming the lender as the insured. Noninstitutional lenders should consider using an ALTA policy when (1) the loan is substantial, (2) the borrower's equity investment is minimal, or (3) there are specific off-record risks (*e.g.,* mechanics' liens). If the borrower is paying the premium for the lender's policy, sophisticated noninstitutional lenders may require the ALTA extended coverage policy. Such coverage is not always available to noninstitutional lenders. The availability of extended coverage varies from insurer to insurer and from case to case, depending on the title company's analysis of the underwriting risks. Sellers who were in actual possession of the property and are taking back financing are less likely to need the extra protection afforded by the ALTA extended coverage policy.

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§6.9 (2) Controversial Provisions

The 1970 ALTA lender's policy was revised in 1987, 1990, 1992, and 2006. The 1992 version introduced several provisions that have proven controversial with institutional lenders. Among other things, it includes a creditors' rights exclusion, an environmental regulation exclusion, and an arbitration provision. For a comparison of the 1970 and 1992 loan policies, see §§6.85-6.88. For a comparison of the 1992 and 2006 loan policies, see §§6.89-6.97.

ALTA has withdrawn the 1970 policy, but some title insurance companies have filed with the Insurance Commissioner policies that are substantially similar to the 1970 ALTA lender's policy and continue to issue such policies to lenders on a case-by-case basis. For the form 1992 ALTA lender's policy, see App I; for the form 2006 lender's policy, see App J.

NOTE: Although both CLTA and ALTA have modified their forms and newer forms are in use, older form policies remain relevant not only because some insureds continue to seek issuance of policies comparable to the withdrawn policies but also because disputes and litigation occur under the older form policies still in effect.

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d. ALTA Owner's Policy

§6.10 (1) Extended Coverage

Owners who desire more extensive coverage than that provided in the CLTA policy can obtain an ALTA owner's policy, which is designed as an extended coverage policy. The ALTA owner's policy is essentially identical to the ALTA lender's policy but does not contain the insuring clauses peculiar to protection of the lien of the deed of trust. It may also be used as a standard coverage policy by the addition of certain preprinted exceptions, known as the Western Regional Exceptions.

The ALTA owner's policy was revised in 1987, 1990, 1992, and 2006, and includes a creditors' rights exclusion, a coinsurance clause, and revised definitions of "unmarketability" and "public records." Because of these additions, some commercial owners who are involved in high-liability transactions request that title insurance companies issue a policy comparable to the 1970 ALTA owner's policy. For the 1992 ALTA owner's policy, see App K. For the 2006 ALTA owner's policy, see App L. For a comparison of the 1970 and 1992 owner's policies, see §§6.85-6.88. For a comparison of the 1992 and 2006 owner's policies, see §§6.98-6.104.

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§6.11 (2) Need for Survey

Before issuing the policy, the underwriter may require that the owner obtain a survey and that the policy contain exceptions for matters reflected in the survey. Title companies may be willing to waive the survey requirement, however, depending on the nature of the property and whether any easements or encroachments exist. The ALTA owner's policy itself is somewhat more expensive than the CLTA policy but, when used as an extended coverage policy, it provides significantly greater coverage.

PRACTICE TIP: In deciding whether to obtain an ALTA owner's policy, the owner should weigh the cost of the policy (and the survey, if required) against the risk to be shifted. The following factors may make a survey and an ALTA owner's policy cost effective:

- Problematic easements or encroachments or significant improvements that could be affected by such easements or encroachments;
- The buyer's lack of familiarity with the property;
- The nature of the property (*e.g.,* rural and not subdivided);
- The type of property description (*i.e.,* metes and bounds, especially if a water course is involved);
- Whether access to the property is crucial or problematic; or
- Whether the owner intends to obtain a survey either before or shortly after closing.

Owners are less likely to order an ALTA extended coverage policy if improvements have been in place for a long time, improvements are not located close to a boundary line, and no significant changes to the property are anticipated.

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§6.12 3. Other Standard Policies

The ALTA publishes other standard policy forms, which are summarized in §§6.13-6.17 and discussed at greater length in §§7.50-7.63, 8.34-8.39. These policy forms are not frequently used in California. Instead, insureds in California use an ALTA lender's or owner's policy with endorsements to change definitions and to modify coverage to meet the needs of the transactions.

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§6.13 a. 1987 ALTA Residential Policy

The ALTA residential title insurance policy, also known as the plain language policy, is designed for use by the owner of a one-to-four family residential dwelling, residential lot, or condominium unit. It has some coverage similar to the ALTA extended coverage owner's policy but, because this policy is typically used for subdivisions with no history of easement or encroachment problems, the lower risk allows title companies to price them at a rate more comparable to the CLTA owner's policy.

Title companies have introduced expanded ALTA residential title insurance policy forms, which are available at slightly higher rates than the conventional ALTA residential title insurance policies. These policies provide coverages for risks that were previously available only by endorsement. For further discussion of these policies, see §§7.36-7.49. For text of the ALTA residential policy, see App M.

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§6.14 b. 1992 ALTA Leasehold Loan and Owner's Policies Withdrawn and Replaced by Endorsements 13 and 13.1

ALTA formerly offered special leasehold loan and leasehold owner's policies. The 1992 ALTA leasehold loan policy was intended to be used by lenders making a loan secured by a deed of trust on a leasehold estate. The 1992 ALTA leasehold owner's policy was intended to be used by the holder of a leasehold estate. These policies were similar to the ALTA lender's and owner's policies but included certain clauses and provisions peculiar to the leasehold situations.

Many lenders and owners were reluctant to accept a policy different from the customary owner's and lender's forms. Further, these specialized policies were criticized as being designed primarily for office leases with modest tenant improvements, and insufficient for ground leases or contemplated construction. Instead of using these forms, California title insurance companies often issued an endorsement to be used with the ALTA lender's or owner's policy, as applicable, to change definitions as necessary to make those policies correspond to the leasehold situation.

In 2001, the ALTA withdrew the leasehold owner's and leasehold lender's policies, and adopted ALTA Endorsement 13 (Owner) and Endorsement 13.1 (Lender) for use with the ALTA owner's and lender's policies. The most recent versions of these endorsements are 13-06 and 13.1-06. The CLTA Endorsement series 119 is similar.

ALTA Endorsements 13-06 and 13.1-06 add a definition of "evicted" or "eviction," which contains two parts: "(a) the lawful deprivation, in whole or part, of the right of possession insured by this policy, contrary to the terms of the Lease; or (b) the lawful prevention of the use of the land or the Tenant Leasehold Improvements for the purposes permitted by the Lease." An unknown covenant or easement could cause significant loss to a lessee by preventing the lessee's intended use of the property, without losing the right of possession, so the second portion of the definition could be a significant benefit.

Endorsement 13.1-06 for a lender's policy adds to the definition of "Tenant" the insured lender who acquires title by foreclosure or deed in lieu. This ensures the continuation of insurance provisions of the lender's policy form will apply to the leasehold estate acquired after foreclosure.

Section 2 of both endorsements provides valuation of the loss of a leasehold estate. This new definition gives the insured the option of valuing the leasehold estate and any tenant leasehold improvements either together or separately.

The 1992 Leasehold Owner's Policy form included the following "miscellaneous items of loss":

- The cost of removing and relocating the insured's personal property within a 25-mile radius, and the reasonable cost of repairing any personal property damaged by reason of removal and relocation;
- Rent or use-and-occupancy payments the insured may be obligated to pay a party having paramount title to that of the landlord;
- Post-eviction rent that the insured is obligated to continue to pay the landlord for the land from which the insured has been evicted;
- The fair market value of the insured's interest in any subleases; and
- Any damages that the insured is obligated to pay a sublessee on account of a corresponding breach of a sublease.

In addition to the loss of the lease, further recoverable damages are listed in Section 3 of both endorsements. These additional damages represent a significant expansion from prior available title insurance by adding consequential losses that might be suffered due to the loss of the value of subleases, the loss of sublease income, and damages due to subtenants. The endorsements expand or add items of loss, as follows:

- The endorsements increase the scope of moving expenses for removing and relocating personal property to include a move of up to 100 miles (formerly 25 miles).
- The endorsements expand the additional items of loss to include reasonable costs incurred by the insured to secure a replacement leasehold equivalent to the leasehold estate.
- The endorsements also expand the additional items of loss to include actual costs incurred by the insured, less salvage value, for tenant leasehold improvements. These costs include costs to obtain land use, zoning, building,

and occupancy permits, architectural and engineering fees, construction management fees, costs of environmental testing and reviews, and landscaping costs.

- Similarly, improvement value is included if the insured tenant is unable to use the property for its intended purpose as a result of a matter covered by the policy, assuming the lease permits such a use.

On leasehold owner's policy, see §§7.55-7.57. On ALTA leasehold loan policy, see §8.39. On leasehold interests generally, see Retail Leasing: Drafting and Negotiating the Lease (Cal CEB 2007); Office Leasing: Drafting and Negotiating the Lease (Cal CEB 1996); Ground Lease Practice (2d ed Cal CEB 2009).

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§6.15 c. 1992 ALTA Residential Loan Policies

The ALTA short-form residential loan policy, an abbreviated version of the current ALTA lender's policy, is customarily issued to a lender at the closing of a loan when it is anticipated that the loan will immediately be sold into the secondary market.

The ALTA master residential loan policy, containing certain blanket exceptions for taxes, covenants and restrictions, easements, and reservation of mineral rights, enables a lender to reduce the amount of paper in its files by not requiring delivery of the entire policy and common endorsements for each loan.

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§6.16 d. 1992 ALTA Construction Loan Policy

The principal difference between the ALTA construction loan policy (rarely used in California) and the ALTA lender's policy is that the construction loan policy does not include mechanics' lien coverage. To obtain mechanics' lien coverage, an ALTA Form A or B endorsement or a CLTA series 101 endorsement must be obtained. See §§8.35-8.36, 8.83-8.84.

On mechanics' liens, see §6.47; California Mechanics' Liens and Related Construction Remedies (3d ed Cal CEB 1998).

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§6.17 e. 1991 ALTA United States Policy

The 1991 ALTA United States policy is designed to insure title in the United States or a United States government agency. The policy insures against loss or damage resulting from failure of the title policy to name any party that has an interest in the land, which was disclosed by the public records immediately before the filing of the lis pendens or declaration of taking by the insured. On the 1991 ALTA United States policy, see §§7.62-7.63.

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§6.18 II. ANATOMY OF TITLE POLICY

The title policy consists of the following sections:

- Face page, which contains the affirmative covenants of indemnity and lists the matters insured against by the policy (see §§6.19-6.33);
- Exclusions from coverage (see §§6.34-6.48);
- Schedule A, which identifies the interest insured (*e.g.,* fee or leasehold); names the insured; and describes the land, the date of the policy, and the amount (see §6.49);
- Schedule B, which describes the exceptions (see §§6.50-6.57);
- Conditions and stipulations (see §§6.58-6.84); and
- Endorsements, if any, that add or subtract coverage (for owner's endorsements, see §§7.64-7.103; for lender's endorsements, see §§8.50-8.118).

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§6.19 A. Face Page

The face page of the title insurance policies consists of three parts:

- The statement of indemnification in the opening paragraph;
- The list of matters insured against (the insuring clauses); and
- The statement of defense coverage in the closing paragraph.

For face page of the CLTA standard coverage policy, see App H. For face page of the 1992 ALTA lender's policy, see App I. For face page of the 1992 ALTA owner's policy, see App K. For face page of the 2006 ALTA lender's policy, see App J. For face page of the 2006 ALTA owner's policy, see App L.

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§6.20 1. Statement of Indemnification

The statement of indemnity coverage in the CLTA policy, the ALTA lender's policy, and the ALTA owner's policy provides that the title insurance company insures against loss or damage sustained by certain enumerated matters shown on the face page of the policy. This coverage is limited by the exclusions, exceptions, and conditions and stipulations found in the remainder of the policy.

Use of the words "loss or damage" in an insurance policy indicates that the policy is indemnity insurance. The title insurance company is responsible for loss or damage incurred by an insured as a result of a defect, lien, encumbrance, or other covered matter. This responsibility contrasts with that of a life insurance company, for instance, which does not measure the amount owed under a life insurance policy by damages sustained by the policy holder. The lender's and owner's policies contain the same statement of indemnification but, as noted in §§6.74, 8.42-8.43, 11.5-11.14, the damages recoverable by an insured lender and an insured owner and the timing of the recovery of such damages can be substantially different.

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Source: Real Property/California Title Insurance Practice/6 Structure and Coverage of Title Insurance Policy Forms/ §6.21 2. Matters Insured

§6.21 2. Matters Insured

For ease of comparison, the matters covered by the CLTA policy, the 1992 and 2006 ALTA loan policies, and the 1992 and 2006 ALTA owner's policies are set forth below:

CLTA Policy	1992 ALTA Owner's Policy	1992 ALTA Loan Policy	2006 ALTA Owner's Policy	2006 ALTA Loan Policy
Title vested other than as stated in the policy (see §6.22)	Title vested other than as stated in the policy (see §6.22)	Title vested other than as stated in the policy (see§6.22)	Title vested other than as stated in the policy (see §6.22)	Title vested other than as stated in the policy (see §6.22)
Defects in title or liens or encumbrances on title (see §6.23)	Defects in title or liens or encumbrances on title (see §6.23)	Defects in title or liens or encumbrances on title (see §6.23)	Defects in title or liens or encumbrances on title (see §6.23)	Defects in title or liens or encumbrances on title (see §6.23)
Unmarketability of title (see §§6.24-6.26)	Unmarketability of title (see §§6.24-6.26)	Unmarketability of title (see §§6.24-6.26)	Unmarketability of title (see §§6.24-6.26)	Unmarketability of title (see §§6.24-6.26)
Lack of a right of access to and from the land (see §6.27)	Lack of a right of access to and from the land (see §6.27)	Lack of a right of access to and from the land (see §6.27)	Lack of a right of access to and from the land (see §6.27)	Lack of a right of access to and from the land (see §6.27)
			Enforcement of police powers laws, ordinances, permits, and regulations relating to building and zoning, subdivisions, and environmental protection if notice of violation or intention to enforce is recorded in the public record (see §6.36)	Enforcement of police powers laws, ordinances, permits, and regulations relating to building and zoning, subdivisions, and environmental protection if notice of violation or intention to enforce is recorded in the public record (see §6.36)
			Enforcement of police powers other than those noted in Covered Risk 5 if notice of enforcement appears in the public records (see §6.37)	Enforcement of police powers other than those noted in Covered Risk 5 if notice of enforcement appears in the public records (see §6.37)
			Pending exercise of eminent	Pending exercise of eminent

			domain power if notice of exercise is recorded in the public records (see §6.39)	domain power if notice of exercise is recorded in the public records (see §6.39)
			Prior taking by a governmental body that is binding on a bona fide purchaser for value and without notice (see §6.39)	Prior taking by a governmental body that is binding on a bona fide purchaser for value and without notice (see §6.39)
			Creditors' rights coverage (see §6.48)	Creditors' rights coverage (see §6.48)
			Post-policy coverage (see §7.35G)	Post-policy coverage (see §6.97)
FOR LENDERS ONLY: Invalidity or unenforceability of the lien of the insured mortgage on the title (see §6.28)		Invalidity or unenforceability of the lien of the insured mortgage on the title (see §6.28)		Invalidity or unenforceability of the lien of the insured mortgage on the title (see §6.28)
FOR LENDERS ONLY: Priority of any lien or encumbrance over the lien of the insured mortgage (see §6.29)		Priority of any lien or encumbrance over the lien of the insured mortgage (see §6.29)		Priority of any lien or encumbrance over the lien of the insured mortgage (see §6.29)
FOR LENDERS ONLY: Invalidity or unenforceability of any assignment of the insured mortgage (if the assignment is shown in Schedule B) or failure of the assignment to vest title to the mortgage in the insured assignee, free and clear of liens (see §6.32)		Invalidity or unenforceability of any assignment of the insured mortgage (if the assignment is shown in Schedule A) or failure of the assignment to vest title to the mortgage in the insured assignee, free and clear of liens (see §6.32)		Invalidity or unenforceability of any assignment of the insured mortgage (if the assignment is shown in Schedule A) or failure of the assignment to vest title to the mortgage in the insured assignee, free and clear of liens (see §6.32)
		Lack of priority of		Lack of priority of

		the lien of the insured mortgage over certain mechanics' liens (see §6.30)		the lien of the insured mortgage over certain mechanics' liens (see §6.30)
		Any assessments for certain street improvements that gain priority over the lien of the insured mortgage (see §6.31)		Any assessments for certain street improvements that gain priority over the lien of the insured mortgage (see §6.31)

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§6.22 a. Vesting of Title

The indemnity language refers to Schedule A of the title policy, which describes how title is vested as of the date of the policy. If the actual vesting differs from the vesting as insured, the insurer is liable for the resulting damages. Although the vesting in Schedule A is generally for fee title, lesser estates such as leaseholds and easements are also insured.

EXAMPLE: In *Hall v San Jose Abstract & Title Ins. Co.* (1959) 172 CA2d 421, 342 P2d 362, the court held that the insured could recover for damages sustained because the policy inaccurately reported that title was held in joint tenancy. Title was actually held by the insured and her husband as tenants-in-common. Thus, instead of taking fee interest in the property through joint tenancy on the death of her husband, the insured was limited to a life estate under the terms of the husband's will. See §11.61.

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§6.23 b. Defects, Liens, and Encumbrances on Title

The title policy covers damages resulting from "[a]ny defect in or lien or encumbrance on title," subject, of course, to the stated policy limits and the exclusions, exceptions, and conditions and stipulations in the policy. A defect is a flaw in title.

EXAMPLE: Defects in title include such matters as lack of competency or capacity of grantors in the chain of title or off-record grants. See Palomar, Title Insurance Law §9.05 (1994); Burke, Law of Title Insurance, chap 3 (3d ed 2000); Anno, *Title Insurance Policy: What Constitutes a Charge, Encumbrance, or Lien Within Contemplation of Title Insurance Policy*, 87 ALR3d 764 (1978). A recording of a "notice of buildings, structures, or premises classified as either hazardous, substandard or a nuisance" does not constitute a "defect in or lien or encumbrance on the title." *Elysian Inv. Group v Stewart Title Guar. Co.* (2002) 105 CA4th 315, 317, 129 CR2d 372.

As contrasted with a defect, an encumbrance is not an imperfection in the title but rather a claim on the property by a third party, which reduces to some degree the title otherwise held by the insured.

EXAMPLE: Easements, leases, options, deeds of trust, and rights of first refusal are some of the common encumbrances on title. In *1119 Delaware v Continental Land Title Co.* (1993) 16 CA4th 992, 20 CR2d 438, the court held that the conditions set forth in a conditional use permit recorded against and imposed specifically on the insured property constituted an encumbrance on title. Conversely, the courts have held that violations of land use restrictions (see *Hocking v Title Ins. & Trust Co.* (1951) 37 C2d 644, 234 P2d 625; *Nishiyama v Safeco Title Ins. Co.* (1978) 85 CA3d Supp 1, 149 CR 355) and violations of environmental protection laws (see *Lick Mill Creek Apartments v Chicago Title Ins. Co.* (1991) 231 CA3d 1654, 283 CR 231) are not defects, liens, or encumbrances. Some government regulation matters, however, are covered by an insuring clause within Exclusions 1(a) and 1(b) for certain recorded notices. See §6.36.

A lien is a claim on property as security for payment of an obligation. CC §2872. A lien is a type of encumbrance and is therefore included within the broader term "encumbrance." CC §1114. See §11.64.

EXAMPLE: Liens include federal and state tax liens, fixture filings, and abstracts of judgment.

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c. Unmarketability of Title

§6.24 (1) Definition of "Unmarketability"

If title to the property is unmarketable, the policy covers resulting loss or damage. The definition of "unmarketability of the title" in the CLTA and 1992 ALTA policies focuses on matters that would permit a purchaser of the property to "be released from the obligation to purchase by virtue of a contractual condition requiring the delivery of marketable title."

The 2006 ALTA owner's and lender's policies delete the term "unmarketability of the title" in favor of "Unmarketable Title," defined as

> Title affected by an alleged or apparent matter that would permit a prospective purchaser or lessee of the Title or lender on the Title or a prospective purchaser of the Insured Mortgage to be released from the obligation to purchase, lease or lend if there is a contractual condition requiring the delivery of marketable title.

NOTE: The reference to lessees and lenders in the 2006 policies' definition of "Unmarketable Title" appears to be an expansion of coverage from the earlier policies.

NOTE: The title policies' definition of "unmarketability" uses the term "marketable title" but does not define it. The authors do not know of any California case that defines "marketable title" in the context of title insurance polices, although the court in *King v Stanley* (1948) 32 C2d 584, 197 P2d 321, overruled on other grounds in *Patel v Liebermensch* (2008) 45 C4th 344, 351 n4, 86 CR3d 366, did discuss "merchantability."

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§6.25 (2) Factors That Do Not Affect Unmarketability

Certain matters may restrict use of the property or adversely affect its value or marketability but do not make the *title* unmarketable. For instance, Subdivision Map Act violations may have a serious impact on the value of the property, but they are not covered by the title policy. "One can hold perfect title to land that is valueless; one can have marketable title to land while the land itself is unmarketable." *Hocking v Title Ins. & Trust Co.* (1951) 37 C2d 644, 651, 234 P2d 625. See also *Lick Mill Creek Apartments v Chicago Title Ins. Co.* (1991) 231 CA3d 1654, 283 CR 231; *Nishiyama v Safeco Title Ins. Co.* (1978) 85 CA3d Supp 1, 149 CR 355.

A notice of default under a deed of trust does not make title unmarketable. *Glavinich v Commonwealth Land Title Ins. Co.* (1984) 163 CA3d 263, 209 CR 266. A lis pendens recorded because of the insured's wrongful conduct in buying the property does not make title unmarketable. *Safeco Title Ins. Co. v Moskopoulos* (1981) 116 CA3d 658, 172 CR 248.

In *Moskopoulos*, the insured previously sued a property owner for specific performance of an alleged sale contract. The owner next conveyed title to Moskopoulos, and Safeco issued a title policy to Moskopoulos. The prior owner then sued Moskopoulos—alleging fraud, abuse of process, and rescission—and recorded a lis pendens against the property. Moskopoulos tendered the defense to Safeco, which filed suit seeking declaratory relief that the claim was not covered by the title policy. The court concluded that the claim was not covered by the insuring clauses of the policy, because title to the property was not at issue but rather how the defendant acquired that title. The insured also claimed that the lis pendens recorded by the prior owner made the title unmarketable. The court held that because this event occurred after the effective date of the policy, it was not covered. See *Barczewski v Commonwealth Land Title Ins. Co.* (1989) 210 CA3d 406, 258 CR 386; *Smith v Commonwealth Land Title Ins. Co.* (1986) 177 CA3d 625, 223 CR 339.

Contamination on the property does not make title unmarketable. Current title policies contain coverage for matters such as environmental protection liens shown by the public records. On environmental regulation exclusion, see §6.86. This coverage, however, does not extend beyond title matters found in the public records. *Lick Mill Creek Apartments v Chicago Title Ins. Co., supra*.

For further discussion of unmarketability, see §11.62.

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§6.26 (3) Effect of Title Insurance Company's Unwillingness to Issue Policy

Does the willingness of a title insurance company to issue a title policy by itself establish that the title is marketable? This single factor was held sufficient in *King v Stanley* (1948) 32 C2d 584, 197 P2d 321, overruled on other grounds in *Patel v Liebermensch* (2008) 45 C4th 344, 351 n4, 86 CR3d 366, but not in *Nebo, Inc. v Transamerica Title Ins. Co.* (1971) 21 CA3d 222, 98 CR 237. The difference between these holdings may be explained by the fact that the title insurance in *Nebo* was offered in the midst of pending title litigation. Because few titles have no flaw in their chain of title, a title insurance company's willingness to issue insurance may help establish marketable title even if it is not conclusive. On insuring over defects, see §6.3.

EXAMPLE: Assume during the examination of title that the title company discovers a defective decree of dissolution recorded many years earlier in the chain of title. If the title company is willing to rely on the decree regardless of any defect that is found, the title is arguably marketable because of the availability of title insurance.

The ability to issue insurance without reference to certain defects raises the potential for fraud. See *Moe v Transamerica Title Ins. Co.* (1971) 21 CA3d 289, 98 CR 547, in which the court found that the title company employee had participated in an intentional fraud to conceal a known bankruptcy. See Anno, *Defects Affecting Marketability of Title Within Meaning of Title Insurance Policy*, 18 ALR4th 1311 (1982).

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§6.27 d. Lack of Right of Access

Owners and lenders are insured against lack of a *right* of access to the land. A right of access can be different from practical or physical access.

EXAMPLE: If the insured property is landlocked, it has no right of access. If the insured property is contiguous to a public road but so steeply sloped as to make physical access impractical or extremely expensive, it still has a right of access.

In rural areas, the right of access often depends on historic, off-record prescriptive easement rights. If the title insurer is satisfied by the historic use, it will insure against lack of a right of access even in the absence of recorded access. In fact, the generic insuring clause for lack of a right of access is important only in this context. If there is an adequate recorded right of access, it will be shown and insured as an easement parcel (and described as part of the subject property together with the fee parcel). If that step is taken, the insuring clause for access is unnecessary. The right of access to the "land" means access to the property actually insured. If the property is not landlocked, and the property description contained in the policy does not include easement rights in an adjacent parcel, the insuring language of the policy will not cover an implied easement in the adjacent parcel. *Havstad v Fidelity Nat'l Title Ins. Co.* (1997) 58 CA4th 654, 68 CR2d 487. See §11.65.

PRACTICE TIP: An insured that desires coverage for a specifically recorded route of access should request that the title insurance company include any easement needed for that route as an additional parcel in the legal description of the insured property. A CLTA 103.4 endorsement is also available for a specific access route and should be considered any time a specific route is important to the insured. A CLTA 103.7 endorsement is available to provide insurance that the property abuts a public street. See §§7.72-7.73, 8.59-8.60. In large transactions, an insured that is obtaining a CLTA 103.7 endorsement may request the insurer to tie that endorsement to a specific survey showing that the curb cuts provide access to the public street. The insurer may require evidence of approval by the governing authority for the specific routes of access.

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§6.28 e. Validity or Enforceability of Lien

The ALTA lender's policies insure the validity and enforceability of the lien of the insured mortgage.

EXAMPLE: If an insured lien is rendered unenforceable because the deed of trust was recorded before satisfaction of a condition precedent, both the conveyance and the lien of the deed of trust are invalid. See *Kish v Bay Counties Title Ins. Co.* (1967) 254 CA2d 725, 62 CR 494. See also *Far W. Sav. & Loan Ass'n v McLaughlin* (1988) 201 CA3d 67, 246 CR 872.

The title policy does not provide coverage for the enforceability of all the provisions of the deed of trust or mortgage. If, for instance, the private power-of-sale provisions are inadequate to permit a nonjudicial foreclosure, coverage is not triggered as long as the lien of the mortgage or deed of trust remains valid. The insured's remedy is judicial foreclosure.

It is also possible for the underlying obligation (typically a promissory note) to be invalid or unenforceable without triggering title policy coverage with regard to validity or enforceability of the mortgage. If, for instance, a court found the note to be usurious or unconscionable and therefore invalidated it, that act would not invoke coverage because there was no inherent invalidity in the lien of the mortgage itself. The authors know of no California cases interpreting this clause.

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§6.29 f. Priority of Lien or Encumbrance

The lender is insured against loss of priority of the lien of its insured mortgage by reason of other liens or encumbrances. See *Lawrence v Chicago Title Ins. Co.* (1987) 192 CA3d 70, 237 CR 264. On limits on damages, see §§8.42-8.45. See also §§11.10-11.14.

EXAMPLE: If there is a prior deed of trust that is not listed among the exceptions to coverage, the insured would be covered for damages caused by loss of priority based on the lien of the preexisting deed of trust.

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§6.30 g. Lack of Priority Over Mechanics' Liens

The ALTA lender's policies cover the lender for damages resulting from a mechanics' lien that takes priority over the lien of the insured deed of trust if the mechanics' lien arises from work of improvement commenced or contracted for:

- Before the date of the policy; or
- After the date of the policy and financed by proceeds of the indebtedness secured by the insured deed of trust.

On mechanics' liens excluded from coverage, see §6.47.

EXAMPLE: Under an ALTA lender's policy, if a homeowner records a construction deed of trust securing a loan used to build a second story on a home, the mechanics' lien claim of a contractor who works on construction of the second story is a covered matter under the lender's policy, whether or not the contract was entered into or the improvement was commenced before the deed of trust is recorded. If, however, a contractor contracts, after the deed of trust is recorded, to build a swimming pool on the same property and is not paid from the proceeds of the insured loan, the mechanics' lien claim is not a covered matter. The claim of a fence builder (and that contractor's subcontractors and material suppliers) is covered, if that improvement is contracted for or commenced before recording of the deed of trust, even if proceeds of the insured loan are not used.

The CLTA policy does not cover mechanics' liens, unless they are recorded before issuance of the policy and not excepted from coverage. Mechanics' lien coverage is available through use of a CLTA series 101 endorsement. See §§7.88-7.89, 8.83-8.84. The authors know of no California cases interpreting this provision.

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§6.31 h. Assessments for Street Improvements

The ALTA lender's policies (but not the CLTA policy) issued in California further insure the lender against loss of priority of its deed of trust for street assessments that are under construction or completed as of the date of the policy. The authors know of no California cases interpreting this provision.

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§6.32 i. Validity or Enforceability of Assignment

If an assignment of the mortgage is recorded at the time the policy is issued, the policy insures the validity of this assignment, which is shown in Schedule B of the CLTA policy and Schedule A of the ALTA lender's policies. In this situation, the policy is issued directly to an assignee. If a new policy is not being issued, a CLTA series 104 endorsement can be issued in favor of the assignee. The authors know of no California cases interpreting this provision.

On assignment by the lender generally, see §6.60.

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§6.33 3. Statement of Defense Coverage

The last paragraph of the face page of the title policy contains the title insurance company's agreement to pay the costs, attorney fees, and expenses incurred in defense of the title or the lien of the insured mortgage—but only to the extent provided in the conditions and stipulations of the policy.

Unlike the amount of liability coverage for claims (see §6.74), the amount of defense costs for which the company may be liable are not limited in the policy. Under the language of the form policies, defense costs do not reduce the amount of the policy. It is possible for the costs of defense to exceed the amount of liability under the policy. See *Barczewski v Commonwealth Land Title Ins. Co.* (1989) 210 CA3d 406, 258 CR 386; *Safeco Title Ins. Co. v Moskopoulos* (1981) 116 CA3d 658, 172 CR 248. See also California Liability Insurance Practice: Claims & Litigation, chap 4 (Cal CEB 1991). On the duty to defend, see §§12.27-12.34.

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§6.34 B. Exclusions From Coverage

The following matters are excluded from coverage under the CLTA policy, the ALTA lender's policies and the ALTA owner's policies:

- Certain laws, ordinances, government regulations, and government police powers (see §§6.35-6.38);
- Rights of eminent domain (see §6.39);
- Certain defects, liens, encumbrances, and adverse claims (see §§6.40-6.45); and
- Creditors' rights claims (see §6.48).

These exclusions are significant because the insurance company has no obligation to either indemnify or defend the insured for losses arising by reason of an excluded matter.

In addition, the following are excluded from coverage under the CLTA policy and/or the ALTA lender's policies:

- Unenforceability of the lien of the insured mortgage because of inability or failure to comply with "doing-business" laws (see §6.46).
- Invalidity or unenforceability of the lien of the insured mortgage as a result of usury or consumer credit protection or truth-in-lending laws (see §6.46).
- The ALTA lender's policies exclude certain mechanics' liens (see §6.47).
- The 2006 ALTA lender's policy and 2006 ALTA owner's policy add an exclusion for liens of real estate taxes or assessments that are imposed, created, or attach between the date of the policy and the date of recording of the insured mortgage (see §§6.97, 7.35G).

For exclusions from coverage in the CLTA policy, see App H. For exclusions from coverage in the 1992 ALTA lender's policy, see App I. For exclusions from coverage in the 1992 ALTA owner's policy, see App K. For exclusions in the 2006 ALTA lender's policy, see App J. For exclusions in the 2006 ALTA owner's policy, see App L.

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§6.35 1. Government Regulations, Powers, and Rights

Although the exclusions generally limit coverage, Exclusion 1 of the CLTA policy and the 1992 and 2006 ALTA lender's and owner's policies provide coverage to the extent that such notices are recorded. The CLTA and the 1992 ALTA policies provide this coverage through exceptions to the exclusion; the 2006 ALTA policies provide the coverage by stating that the exclusion does not modify or limit the coverage provided in certain covered risks. If a notice is recorded, it must be disclosed in Schedule B of the policy; otherwise the insurer will be liable for damages to the insured resulting from failure to disclose the notice.

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§6.36 a. Laws, Ordinances, or Government Regulations

Exclusion 1(a) of the CLTA policy and the 1992 ALTA lender's and owner's policies excludes losses resulting from certain laws, ordinances, or government regulations relating to the property, including building and zoning laws and environmental laws *except* to the extent that a notice of enforcement or a notice of a defect, lien, or encumbrance resulting from a violation or an alleged violation has been recorded in the public records as of the date of the policy. The 2006 ALTA lender's and owner's policies exclude the same losses but, rather than providing an exception to the exclusion, state that the exclusion does not modify or limit the coverage provided in Covered Risk 5.

The reason for the exclusion is that such laws, ordinances, and government regulations relate to the ability to use the property and are not defects, liens, or encumbrances that would typically be found in the chain of title. By contrast, the recorded notices are in the public records for the subject property and are therefore discoverable through a title search.

EXAMPLE: Any land use regulation falls within Exclusion 1(a), including density, height, dimensional, and use restrictions and zoning categories, even if, as sometimes happens, the zoning is recorded. If, however, the governing body records a notice of violation of the zoning ordinance against the insured property, that fact would be covered by the policy. Coverage is now provided for the recorded notices (such coverage was not included in earlier policies), requiring the title company to track these recorded violations. Recorded notices covered by this provision include notices of a substandard dwelling, violations of building or occupancy permits, or violations of zoning or subdivision laws.

An owner or a lender who desires coverage for zoning matters may request a CLTA 123.1 or 123.2 endorsement, which (1) identifies the zoning classification and the types of improvements permitted by that classification and (2) provides certain coverage for enforced removal or interference with use of the improvements resulting from certain zoning violations. On zoning endorsements, see §§7.97-7.98, 8.101. The CLTA 116.7 endorsement is available to assure compliance with the Subdivision Map Act (Govt C §§66410-66499.37) and related local ordinances. On subdivision endorsements, see §§7.94-7.96, 8.93-8.94.

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§6.37 b. Police Power

Exclusion 1(b) of the CLTA policy and the 1992 and 2006 ALTA lender's and owner's policies applies to losses resulting from exercise of the government police power unless there is a recorded notice of the defect, lien, or encumbrance resulting from a violation affecting the land. The CLTA and the 1992 ALTA policies provide for exceptions to the exclusion; the 2006 ALTA policies state that the exclusion does not modify or limit the coverage provided in Covered Risk 6.

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§6.38 c. Judicial Interpretation of Exclusion 1

In *1119 Delaware v Continental Land Title Co.* (1993) 16 CA4th 992, 20 CR2d 438, the court concluded that a conditional use permit recorded against the property was not excluded from coverage by Exclusion 1 because the conditional use permit was a specific restriction imposed on the insured property rather than a government regulation of general applicability.

In several other cases, the courts discuss Exclusions 1(a) and 1(b). These decisions, however, are not based on an interpretation of these exclusions but rather on the coverage (or lack of coverage) afforded by the insuring clauses of the title policy. See *Hocking v Title Ins. & Trust Co.* (1951) 37 C2d 644, 234 P2d 625 (illegal subdivision); *Lick Mill Creek Apartments v Chicago Title Ins. Co.* (1991) 231 CA3d 1654, 283 CR 231 (contamination clean up costs); *Nishiyama v Safeco Title Ins. Co.* (1978) 85 CA3d Supp 1, 149 CR 355 (Subdivision Map Act violations). See also §§11.68-11.69.

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§6.39 2. Eminent Domain

Exclusion 2 of the CLTA policy and the 1992 and 2006 ALTA lender's and owner's policies provide that damages resulting from the exercise of this power are not covered by the policy unless a notice of exercise of these powers has been recorded as of the date of the policy and is not included in Schedule B. If this occurs, the policy covers damages resulting from a taking occurring before the date of the policy, which is binding on a bona fide purchaser. The CLTA and the 1992 ALTA policies provide for coverage through exceptions to the exclusion; the 2006 ALTA policies state that the exclusion does not modify or limit the coverage provided in Covered Risks 7 or 8. The authors know of no California cases interpreting this exclusion. See §11.70.

EXAMPLE: If, as of the policy date, a local government agency has restricted use of the insured property so that a taking has effectively occurred but no notice has been recorded, the title insurance policy will not cover any losses resulting from this "taking."

Exclusions 1 and 2 highlight the importance of conducting a thorough due-diligence review of the property to be purchased or encumbered; title insurance cannot be relied on for such matters. The insured's attorney should assist in this process and direct the client to the appropriate resources. On eminent domain generally, see Condemnation Practice in California (3d ed Cal CEB 2005).

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3. Certain Defects, Liens, Encumbrances, and Adverse Claims

§6.40 a. Matters Controlled by Insured

Exclusions 3(a)-(b) of the CLTA policy and the 1992 and 2006 ALTA lender's and owner's policies describe matters that are under the control of the insured and are not recorded or otherwise within the actual knowledge of the title insurance company.

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§6.41 (1) Insured Created, Suffered, Assumed, or Agreed to Matter Giving Rise to Loss (Exclusion 3(a))

In *Hansen v Western Title Ins. Co.* (1963) 220 CA2d 531, 33 CR 668, the court held that Exclusion 3(a) applies if the insured has consciously or deliberately created or caused the matter giving rise to the loss. Inadvertence or negligence on the part of the insured is not enough to deprive it of coverage under this exclusion.

After concluding that the claim did not fall within the insuring clauses of the title policy, the court in *Safeco Title Ins. Co. v Moskopoulos* (1981) 116 CA3d 658, 172 CR 248, stated in dicta that (1) Exclusion 3(a) language was ambiguous and (2) the ambiguity should be interpreted against the insurer. The ambiguity did not void the clause entirely. Citing *Hansen v Western Title Ins. Co., supra,* the court said that the insurer had no duty to defend because the insured had acted intentionally and deliberately. See also §11.71.

EXAMPLE: If the insured agreed with the seller to take title subject to a deed of trust that the insurer failed to list as an exception to coverage, that deed of trust would be excluded from coverage under Exclusion 3(a).

In response to *White v Western Title Ins. Co.* (1985) 40 C3d 870, 221 CR 509, in which the court suggested that the insurer has a duty to disclose all matters of record that would be of interest to the insured, the CLTA added to Exclusion 3(a) the phrase "whether or not recorded in the public records." On public records, see chap 4, §6.62. No subsequent cases have interpreted this language. The authors believe that a court is unlikely to hold that the insured is covered by the policy if the matter was created or agreed to by the insured whether the matter was of record or not.

EXAMPLE: If the insured purchased the property and agreed with the seller to take title subject to a recorded deed of trust, a court is unlikely to hold the title insurer liable if it failed to except the deed of trust from coverage regardless of whether the policy exclusion was simply for matters "whether or not recorded in the public records … but … agreed to by the insured claimant" (CLTA policy language) or those "agreed to by the insured claimant" (ALTA policy language).

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§6.42 (2) Insured Knew But Did Not Disclose Matter to Insurer

Exclusion 3(b) of the CLTA policy and the 1992 and 2006 ALTA lender's and owner's policies applies if:

- The insured knows of a matter not disclosed of record and does not disclose the matter in writing to the insurer; and
- The insurer does not otherwise have actual knowledge of the matter.

A prospective insured may avoid the effects of Exclusion 3(b) by disclosing in writing to the insurer any title matters known to it but not to the insurer. If the insurer issues the policy after this notice, the Exclusion 3(b) defense is precluded. See §11.72.

EXAMPLE: If the lender knows that construction has (or may have) commenced before closing, it should advise the title insurer of the fact that construction may have begun (because of the loss of priority that prior commencement represents to the insured deed of trust) and permit the title insurer to conduct its own investigation if it desires to do so. The lender may wish to insert in its escrow instructions a statement that construction has begun on the insured property and that the title insurer should not issue the ALTA lender's policy unless it is willing to do so with knowledge that the lender is relying on it for protection against mechanics' and materialmen's claims to the same degree that it would rely on the policy had no work commenced and the title company's own inspection revealed that fact. On what constitutes commencement of work, see California Mechanics' Liens and Related Construction Remedies §2.68 (3d ed Cal CEB 1998).

Counsel should be alert to matters that are not of record but could affect title (*e.g.,* disputes concerning title, litigation, and off-record partnership or spousal interests) and disclose in writing all such matters to the insurer in a timely manner before the closing of the transaction. Failure to disclose could result in loss of coverage under Exclusion 3(b). The attorney should keep in mind, however, that disclosures may result in the insurer's imposing additional obligations on the insured or vested owner, *e.g.,* indemnity agreements in the case of mechanics' lien issues. On indemnity agreements, see §5.41.

PRACTICE TIP: If a dispute arises about what the insurer knew and the insurer also acted as the escrow agent, the insurer may have acquired knowledge of the matter through its role as the escrow agent.

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§6.43 b. Loss or Damage

Exclusion 3(c) of the CLTA policy and the 1992 and 2006 ALTA lender's and owner's policies restates the indemnity limitation on the face page of the policy. The policy does not cover a defect, lien, or encumbrance that does not result in loss or damage to the insured.

EXAMPLE 1: Assume that the policy describes two separate access easements to the property. If the policy is in error because one of the easements previously was abandoned, the insured receives no compensation unless this error also results in loss or damage. Although two access routes may improve the value of the property, a second access may be superfluous and no loss or damage may result from its nonexistence.

EXAMPLE 2: Assume that the legal description mistakenly includes more property than was bargained for by the insured. Although the additional land clearly has an appraisable value, the insured suffers no loss or damage in returning the additional property to the seller because the insured did not bargain for the additional property. A recovery under these circumstances would constitute a windfall to the insured.

EXAMPLE 3: Assume that a lender discovers the existence of a prior recorded abstract of judgment. The judgment creditor has taken no action, and the loan is current. At this point, the lender has not suffered any loss under the policy. See *Karl v Commonwealth Land Title Ins. Co.* (1993) 20 CA4th 972, 24 CR2d 912; *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 275 CR 107; *Lawrence v Chicago Title Ins. Co.* (1987) 192 CA3d 70, 237 CR 264. On lender's damages generally, see §§8.42-8.45, 11.10-11.14.

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§6.44 c. Post-Policy Claims

Exclusion 3(d) of the CLTA policy and the 1992 ALTA lender's and owner's policies reinforces the restriction on the face page that the title policy is limited to the date of the policy and does not cover matters attaching or created after the date of the policy. See §11.74. In the 1992 ALTA lender's policy, mechanics' liens insured on the face page of the policy are excepted from this exclusion. See §6.30.

EXAMPLE: A lis pendens recorded after the date of the policy is not covered by the policy. See *Safeco Title Ins. Co. v Moskopoulos* (1981) 116 CA3d 658, 172 CR 248. The claim underlying the lis pendens (*e.g.,* a forgery or incompetency in the chain of title before the date of the policy) could, however, be covered under the policy.

If a claim is denied as a post-policy matter, the practitioner should examine the underlying basis of the claim carefully to determine whether it is based on a covered pre-policy interest or defect in title for which there is coverage.

Notably, the 2006 ALTA lender's and owner's policies contain an exception to Exclusion 3(d) for coverage provided under the specified covered risks that do afford post-policy coverage (Covered Risks 11, 13, and 14 in the 2006 ALTA loan policy, and Covered Risks 9 and 10 in the 2006 ALTA owner's policy). See discussion in §§6.97, 7.35G.

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§6.45 d. Value

Exclusion 3(e) of the CLTA policy and the 1992 and 2006 ALTA lender's and owner's policies provides that if the insured is not a bona fide purchaser, any loss or damage resulting from its failure to be a bona fide purchaser is not covered, because it failed to pay value for the property. The purpose of this exclusion is to protect the insured from having to defend a claim when it has lost the bona fide purchaser defense because of a failure to transfer the property for value. The authors know of no cases interpreting this exclusion. See §11.75.

EXAMPLE: Assume that parents give real property to their children as a gift. The parents' creditors then attack the transfer as a fraudulent conveyance. The children tender the defense to the insurer. Under this exclusion, the insurer will refuse to defend, because the children are not bona fide purchasers.

An endorsement to delete this provision may be available depending on the factual circumstances. If a nonprofit corporation receives a donation of land in an arm's length transaction, an endorsement will probably be available. In the above example, an endorsement would probably not be available.

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§6.46 4. Liens Unenforceable Due to Failure to Comply With Certain Laws

Under Exclusions 4 and 5 of the 1992 and 2006 ALTA lender's policies, lenders are not insured if the lien of the mortgage is unenforceable because the insured failed to comply with "doing-business," usury, consumer credit protection, or truth-in-lending laws. These matters are excluded because title insurance companies view them as regulatory matters that are outside the scope of a typical title search. See §§11.76-11.77.

The authors are not aware of any California cases interpreting these exclusions. But see *Title Ins. Co. v American Sav. & Loan Ass'n* (10th Cir 1989) 866 F2d 1284, which involved a statute that prohibited a foreign lender from making loans. The lender failed to comply with the applicable doing-business laws of the state in which the land was located. The resulting loss to the lender was excluded from coverage.

An insured lender can seek coverage through endorsements for compliance with doing-business, usury, and truth-in-lending laws. On such endorsements, see §§8.104-8.105, 8.117-8.118, 8.97-8.98, respectively.

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§6.47 5. Mechanics' Liens

Under Exclusion 6 of the 1992 ALTA lender's policy, certain mechanics' liens are not covered by the policy, but some are. (On mechanics' liens covered by the ALTA policy, see §6.30.) Excluded mechanics' liens are those (1) arising from work begun after the date of the policy and (2) not financed by the proceeds of the insured loan that the insured lender has advanced or is obligated to advance as of the date of the policy. Covered Risk 11 of the 2006 ALTA loan policy has the same practical effect as the exception to Exclusion 6 of the 1992 policy.

EXAMPLE: After closing, the insured asks the insured lender for additional funds to build a gazebo. Under the terms of the insured loan, the lender is *not* obligated to advance additional cash. The lender agrees to give the insured a line of credit. Any mechanics' lien that arises from the insured's failure to pay for construction of the gazebo will not be covered by the ALTA lender's policy.

Exclusion 6 is not in the CLTA policy because that policy does not insure mechanics' liens unless recorded before issuance of the policy and not excepted from coverage. The authors know of no California cases interpreting this exclusion. See §11.78.

For further comparison of obligatory and optional advances, see California Mortgages, Deeds of Trust, and Foreclosure Litigation §9.69 (4th ed Cal CEB 2009). On mechanics' liens, see California Mechanics' Liens and Related Construction Remedies (3d ed Cal CEB 1998). On matters known to the insured and not disclosed to the insurer, see §6.42.

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§6.48 6. Creditors' Rights Exclusions

The creditors' rights exclusions (Exclusion 6 of the CLTA policy, Exclusion 7 of the 1992 ALTA lender's policy, Exclusion 6 of the 2006 ALTA lender's policy, and Exclusion 4 of the 1992 and 2006 ALTA owner's policies) are designed to exclude from coverage matters resulting from certain creditors' claims arising from the insured transaction and involving such matters as fraudulent conveyances, the doctrine of equitable subordination, and preferential transfers. The creditors' rights exclusion applies only to the specific transaction and does not protect the title insurer from other bankruptcy matters that are in the public records but not excluded from coverage by an exception to the policy.

Generally, a bankruptcy filed after the date of the policy is considered to be an excluded post-policy event. An event such as a preferential payment that occurs on or before the date of the policy may, however, result in the setting aside or impairment of the insured transaction under 11 USC §547, §548, or §549 or other federal bankruptcy or state insolvency laws. In the absence of a creditors' rights exclusion in the policy, the insured may tender a claim based on such an event arising from a post-policy bankruptcy. The attorney should be aware, however, that title insurers have always contended that creditors' rights issues do not fall within the ambit of title insurance coverage. The authors know of no California cases on this issue. But see *Chicago Title Ins. Co. v Citizens & S. Nat'l Bank* (ND Ga 1993) 821 F Supp 1492.

EXAMPLE: One form of creditors' rights issue occurs in a leveraged buyout. Assume that the buyer of a corporation causes the corporation to mortgage its assets to generate cash, which is then used by the buyer (*not* by the corporation) to purchase the corporation's stock from its shareholders. The result is an increase in debt for the corporation without an offsetting increase in cash. If no value is given and the corporation is rendered insolvent, the loan may be rendered unsecured on a later set-aside of the lender's mortgage. Any loss to a lender in such an event would not be covered under the policy because of the creditors' rights exclusion.

A practitioner who wants to delete this exclusion by endorsement should, early in the transaction, notify the title company of that fact, inform the title company of the nature of the transaction, and provide the title company with copies of the appropriate documents. These steps will eliminate delays while the insurer analyzes the documents and makes the necessary underwriting decisions. For example, as a condition to eliminating this exclusion in a deed in lieu of foreclosure transaction, insurers frequently require that an appraisal of the property demonstrate that the borrower is not forfeiting equity in the project.

On creditors' rights exclusions, see §§6.88, 7.18-7.20, 8.32, 11.78.

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Source: Real Property/California Title Insurance Practice/6 Structure and Coverage of Title Insurance Policy Forms/ §6.49 C. Schedule A

§6.49 C. Schedule A

Schedule A of the title policy provides the following information particular to the policy then being issued:

- Policy number;
- Amount of insurance;
- Premium for insurance;
- Date of policy;
- Name of insured;
- Estate or interest in land being conveyed or encumbered;
- Designation of how title is vested; and
- Description of the land covered by the policy.

The 1992 and 2006 ALTA lender's policies also include a description of the insured mortgage and assignments. This information is added to Schedule B in a CLTA joint protection policy. For Schedule A in the CLTA policy, see App H. For Schedule A in the 1992 ALTA lender's policy, see App I. For Schedule A in the 2006 ALTA lender's policy, see App J.

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§6.50 D. Schedule B (Exceptions to Title)

All title insurance policies contain some form of Schedule B, which lists exceptions from coverage. Losses resulting from such exceptions are not covered by the title policy.

NOTE: There is no clear distinction between exclusions and exceptions. Different attorneys formulate different definitions for these terms. Generally, exclusions are policy oriented while exceptions are linked to matters found in the public records. The authors do not believe that there is any essential difference between exclusions and exceptions.

The contents of Schedule B indicate whether the title insurance policy is a standard coverage policy or an extended coverage policy. A standard coverage policy contains preprinted exceptions (see §6.51) in addition to the typewritten exceptions. An extended coverage policy contains only the typewritten exceptions (see §§6.52-6.57).

The typewritten exceptions are found in Schedule B, Part II of the CLTA policy; Schedule B, Part I of the 1992 and 2006 ALTA lender's policies; and Schedule B of the 1992 and 2006 ALTA owner's policies.

PRACTICE TIP: Part II of Schedule B is frequently misunderstood. It does not constitute affirmative representations of which matters affect title. Rather, it is a list of risks that the title insurance company excepts from coverage. See §§5.9-5.19.

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§6.51 1. CLTA Standard Coverage Policy

The CLTA policy is designed as a standard coverage title policy to be issued without requiring either a survey or an inspection of the property to look for inquiry notice matters. This policy could be adapted for use as an extended coverage policy by deletion of the preprinted exceptions. The cost and requirements for such an extended coverage policy are the same as for an ALTA extended coverage policy.

The CLTA policy divides Schedule B into two parts. Part I lists the following standard preprinted exceptions:

- Certain taxes, assessments, proceedings, and notice of proceedings not shown in the public records or in the records of the taxing authority;
- Certain facts, rights, interests, or claims not shown in the public records but that could be ascertained by an inspection or asserted by persons in possession;
- Easements, liens, or encumbrances (or claims for easements, liens, or encumbrances) not shown in the public records;
- Specified matters that a correct survey would disclose and that are not shown in the public records; and
- Unpatented mining claims, reservations or exceptions in patents, and water rights or claims or title to water—whether or not such matters are shown in the public records.

For text of Part I, Schedule B of the CLTA policy, see App H. Part II of Schedule B contains the typewritten exceptions relating to the particular property insured. On the CLTA policy, see §6.7. On preprinted exceptions, see §§11.79-11.84. On typewritten exceptions, see §§5.9-5.19, 6.55-6.57, 11.85-11.87.

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§6.52 2. ALTA Policies

Part I of Schedule B of the ALTA lender's policies lists typewritten matters that are prior to the insured mortgage or deed of trust. The 1992 ALTA owner's policy does not break Schedule B into parts. Part II of Schedule B of an ALTA lender's policy shows matters subordinate to the insured mortgage or deed of trust.

For text of Schedule B, see App I (1992 ALTA lender's policy), App K (1992 ALTA owner's policy), App J (2006 ALTA lender's policy) or App L (2006 ALTA owner's policy). On ALTA policies, see §§6.8-6.17.

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§6.53 a. Standard Coverage Policy

If the policy is a standard coverage policy, Schedule B lists all the preprinted exceptions listed in §6.51 and a sixth exception, which deletes the mechanics' lien coverage included on the face page of the ALTA lender's policy. See §6.30. (That exception is not needed on the CLTA policy or the ALTA owner's policies, because mechanics' lien coverage is not given on the face page.) Some title insurers in California refer to these preprinted exceptions added to ALTA policies as Western Regional Exceptions. Thus, an ALTA owner's policy with Western Regional Exceptions is a standard coverage policy comparable to a CLTA policy. See also §§6.5, 6.8.

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§6.54 b. Extended Coverage Policy

If Schedule B of the ALTA policy does not include any standard preprinted exceptions, it is an extended coverage policy. The elimination of some but not all of the exceptions broadens the coverage but does not create a full extended coverage policy. This approach is taken infrequently and is usually part of a negotiated compromise with the title insurer regarding coverage. For instance, if no survey will be furnished, the survey exception may remain in the policy, but the other preprinted exceptions will be deleted.

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§6.55 3. Typewritten Exceptions

In addition to exclusions and preprinted exceptions, the title insurance company adds to Schedule B those exceptions found in its title search that relate to the insured property and the proposed transaction. As noted in chap 4, the search of the public records includes not only matters affecting the specific land searched (*e.g.,* easements, deeds of trust) but also general liens or other actions found of record affecting the owner (*e.g.,* bankruptcy, judgments, tax liens, probates, trusts, conservatorships, dissolutions). The typewritten exceptions are typically the same exceptions that were set forth in the preliminary report or the commitment. On common typewritten exceptions, see §§5.10-5.19.

The typewritten exceptions are listed in the policy *not* as a representation of fact to the insured regarding the state of title. Rather, they are included for the insurer's protection. Losses or damages resulting from these exceptions are not covered by the title policy. Not every title matter in the public records will be listed in Schedule B. Matters that the title insurance company is willing to insure against will not be listed (*e.g.,* old liens or encumbrances, reconveyed deeds of trust, mechanics' liens for which the title company has obtained an indemnity from the seller).

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§6.56 a. Liability for Description of Exception

An independent investigation is necessary to confirm that an exception is correct (*e.g.,* that the property is actually in an irrigation district). See *Coleman v Security Title Ins. Co.* (1963) 218 CA2d 444, 32 CR 575. For discussion of *Coleman*, see §§11.62, 11.72, 11.84. If, however, the exception does more than merely refer to the recording data of the underlying instruments, the insurer may be liable for any additional mistaken information.

EXAMPLE: If the exception describes the easement as a telephone easement when it is actually an electric utility easement, the insurer is liable if the insured suffers damages as a result of this misstatement. *J. H. Trisdale, Inc. v Shasta County Title Co.* (1956) 146 CA2d 831, 304 P2d 832. For further discussion of *Trisdale,* see §11.72.

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§6.57 b. No Obligation to Show Status of Lien

It is sufficient for title purposes for the policy to show the lien of a deed of trust against title. Although a title policy frequently shows recorded notices of default, the failure of a policy to do so is not a covered loss because the notice is not a defect, lien, or encumbrance. *Glavinich v Commonwealth Land Title Ins. Co.* (1984) 163 CA3d 263, 209 CR 266. In other words, the title policy is not a credit report regarding the amount owed or delinquent status of the obligation secured by the lien of the deed of trust. The practitioner cannot rely on the absence of a mention of a notice of default in the preliminary report or the title policy as evidence that an existing loan is in good standing. The status of the loan must be determined by directly contacting the lender.

PRACTICE TIP: A purchaser that intends to take title subject to the loan should obtain a warranty and representation from the seller/borrower stating that the loan is in good standing. If a notice of default has been sent, the purchaser can obtain a beneficiary statement providing information regarding the default. CC §2943(a)(2)(A).

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§6.58 E. Conditions and Stipulations

Conditions and stipulations are important aids to understanding and determining duties, rights, and liabilities of both the insured and the insurer. The conditions and stipulations in the CLTA and ALTA policies are similar. Those in the CLTA policy apply to both owner and lender coverages and, therefore, the wording differs slightly from the ALTA language. References to paragraph numbers in §§6.59-6.84 are references to paragraphs in the conditions and stipulations.

For conditions and stipulations in the CLTA policy, see App H. For conditions and stipulations in the ALTA policies, see App I (1992 lender's policy), App K (1992 owner's policy), App J (2006 lender's policy), and App L (2006 owner's policy). The 2006 ALTA policies refer to them simply as "conditions," not "conditions and stipulations."

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§6.59 1. Definitions

The conditions and stipulations begin with definitions of significant terms used in the policies. To fully understand the coverage each policy offers, the attorney must analyze the definitions. This chapter discusses the definitions of "insured" and "public records" in detail because of their importance in limiting the scope of coverage of title policies.

For the definition of another significant term, "unmarketability," see §6.24.

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a. Insured

§6.60 (1) Lender

Condition 1(a) of the CLTA policy and the 1992 ALTA lender's policy defines "Insured" to include the lender and certain successors. This definition allows a lender's policy to continue in effect for a purchaser of the indebtedness (except for a purchaser seeking to avoid its own obligations under such instruments as indemnities or bonds, in accordance with Condition 12(c)).

The 2006 ALTA lender's policy contains an expanded definition of "Insured." The definition includes successors in ownership of the indebtedness, whether the successor owns the indebtedness for its own account or as a trustee or fiduciary. The term "Insured" has also been expanded to include the successor to an insured on conversion to a different kind of entity.

This automatic transfer of coverage does not, however, "date down" the policy and, therefore, gives no coverage for subsequent events such as the validity of an assignment of the loan. A CLTA series 104 endorsement is, therefore, typically sought by an assignee of the loan to insure the validity of the assignment. See §§8.63-8.64. On continuation of coverage, see §§6.64-6.67.

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§6.61 (2) Owner

Condition 1(a) of the CLTA policy and the ALTA owner's policy defines "Insured" to include the insured and successors by operation of law. Successors by operation of law would include successors by corporate merger or reorganization. The policy remains in force (as of the date of the policy) for heirs of a deceased insured and for corporate or fiduciary successors but terminates on a transfer of the property by any means other than by operation of law.

In *Kwok v Transnation Title Ins. Co.* (2009) 170 CA4th 1562, 89 CR3d 141, a husband and wife formed a limited liability company that purchased real property to be developed. The LLC purchased a title policy that defined "insured" in part as "the insured named in Schedule A," and "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." 170 CA4th at 1565. Paragraph 2(b) of the conditions and stipulations of the policy provided (170 CA4th at 1565):

> 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 or any transfer or conveyance of the estate or interest.

When neighbors refused to give access to an easement for sewer and drainage, the Kwoks decided to transfer ownership of the property from the LLC to themselves as trustees of a revocable family trust. The Kwoks then filed a lawsuit to enforce their rights, and the neighbors cross-complained. The Kwoks tendered both matters to their title insurer, which denied coverage on the ground that the transfer of the property by the LLC to the Kwoks as trustees was a voluntary act that did not arise by operation of law and therefore terminated coverage. The appellate court held that "coverage did not continue because title to the property did not devolve to appellants as members of the LLC on dissolution of the LLC, but rather was transferred by deed from the named insured to appellants as trustees of their family trust, a totally separate legal entity." 170 CA4th at 1567.

The policy at issue in *Kwok* was a CLTA Standard Coverage Policy of Title Insurance issued in 2004. The 2006 ALTA lender's policy contains an expanded definition of "Insured." The term "Insured" has been expanded to include the successor to an insured on conversion to a different kind of entity. Further, the term "Insured" now includes the grantee in a deed executed by the named insured and delivered for no consideration if the grantee (1) is wholly owned by the named insured, (2) wholly owns the named insured, or (3) is wholly owned by an affiliated entity of the named insured, provided that the affiliated entity and the named insured are both wholly owned by the same person or entity. Finally, the definition of "Insured" also includes the person or entity who has "control" of the "transferable record," if the indebtedness is evidenced by a transferable record as defined by applicable electronic transaction law; this includes third parties, such as MERS (Mortgage Electronic Registration System) or other service providers, even though the third party may not be named when an electronic transaction is involved. See Com C §7106.

On continuation of coverage, see §§6.68-6.71.

PRACTICE TIP: Entities acquiring title to real estate by corporate merger or reorganization should be aware that their coverage will only be through the date in the original policy. Some successors by merger or reorganization may wish to obtain new coverage, through either a reissued policy or a "date down" of the existing policy, naming the successor by merger or reorganization as the insured. The reissued or dated down policy should be available at less than the full policy premium, since the additional coverage only relates to the period after the date of the original policy.

PRACTICE TIP: If a client wishes to transfer title to children, either a new policy or a CLTA 107.9 endorsement (if the transfer is made by a gift) should be obtained that adds the children as additional named insureds to the existing policy. On failure to pay value, see §6.45. If the transfer is made to a revocable trust in which the trustees are the same as the grantors, the trust should also obtain a CLTA 107.9 endorsement or equivalent assurances from the

title insurance company that the trust is insured by the policy. Neither the definition of "owner" nor the provision on continuation of insurance (see §§6.68-6.71) explicitly covers such a transfer to a trust. Note that in *Kwok v Transnation Title Ins. Co.* (2009) 170 CA4th 1562, 89 CR3d 141, the court pointed out that the title insurer's denial letter stated that the Kwoks had not availed themselves of an available endorsement for coverage after transfer to a separate legal entity. When intra-family transfers are contemplated, the attorney should advise the clients to contact the title insurer to determine if coverage may be continued at no cost, or at modest cost, with the appropriate endorsement, or if a new policy is required.

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§6.62 b. Public Records

The definition of "public records" is found in Condition 1(h) of the CLTA policy, Condition 1(f) of the 1992 ALTA lender's and owner's policies, Condition 1(k) of the 2006 ALTA lender's policy, and Condition 1(i) of the 2006 ALTA owner's policy. Public records are those 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 [k]nowledge.

Specifically included in the definition in the ALTA policies are "environmental protection liens filed in the records of the clerk of the United States [d]istrict [c]ourt for the district in which the land is located." The CLTA definition does not refer to environmental liens, because they are superfluous in California, which has adopted legislation permitting such liens to be recorded in the county recorder's office. See Govt C §27280. The effect of this legislation is to negate the constructive notice effect of filing a lien in the district court, as permitted by federal statute (see 42 USC §9607(*l*)(3)).

NOTE: "Public records" do not include most building, safety, health department, and similar records. For further discussion of public records, see chap 4.

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§6.63 2. Continuation of Insurance

The title policy does not necessarily terminate on conveyance or foreclosure of the insured lien. Condition 2 of the CLTA policy and of the 1992 and 2006 ALTA lender's and owner's policies describes under what circumstances insurance continues in effect under each of those policies.

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§6.64 a. Lender

For a lender, the policy continues in force even after the lender acquires title by foreclosure or deed in lieu of foreclosure. *Karl v Commonwealth Land Title Ins. Co.* (1993) 20 CA4th 972, 24 CR2d 912; *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 275 CR 107; *Lawrence v Chicago Title Ins. Co.* (1987) 192 CA3d 70, 237 CR 264. The policy also continues after the lender deeds the foreclosed property to a parent or subsidiary company or to a government agency that guaranteed the debt (*e.g.,* agencies, like the Veterans' Administration and the Federal Housing Association, that insure loans) without affecting the policy. See also §§8.48-8.49.

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§6.65 (1) Lender's Policy Does Not Become Owner's Policy

While the policy continues in effect, it provides coverage only as of the date of the policy and is still a lender's policy (not an owner's policy), limiting the lender's ability to claim losses. For definition of "Insured," see §6.60. On lender's losses, see §§6.67, 8.42-8.45, 11.5-11.14.

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§6.66 (2) Reasons to Obtain Owner's Policy

A foreclosing lender should consider whether to obtain a new owner's policy or to rely on the lender's policy. Any equity in the property in excess of the principal amount of the lender's loan is unprotected by the original policy and, of course, the foreclosure sale itself is not covered by the original policy. Whether or not the lender decides to obtain a new policy depends on a number of factors, including:

- The loan-to-value ratios;
- The lender's confidence in the foreclosure sale or the continued viability of the trustee who conducted the sale;
- The differences in the measure of damages between the lender's and the owner's policy.

On the need for an owner's policy, see §§7.1-7.10.

PRACTICE TIP: The policy insures the priority of the deed of trust. Some lenders elect not to purchase an owner's policy after foreclosure, believing that it provides little additional coverage if the lender followed the statutory requirements under CC §2924 in the foreclosure sale. Others disagree, particularly because of the limitation on when claims can be pursued. See §§8.42-8.45, 11.5-11.14. If the lender plans to sell the property within two years, the purchase of a binder after foreclosure may save costs. See §§3.20-3.26.

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§6.67 (3) Measure of Damages

The fact that the prior policy is a lender's policy but the lender has become an owner is important in the context of measure of damages. In *Karl v Commonwealth Land Title Ins. Co.* (1993) 20 CA4th 972, 24 CR2d 912 (*Karl I*), the court provided a detailed analysis of the principles that apply to a claim by an insured lender that has foreclosed on its deed of trust that was junior to encumbrances not listed as exceptions on the title policy.

The lender was repaid in full but lost a potential recovery greater than repayment of the secured indebtedness because of the senior encumbrances. The court held that an insured lender that forecloses on its security sustains a loss on the date of the foreclosure sale if the value of the property received at the foreclosure is less than the secured debt because of the presence of a title defect that is not excepted from coverage. *Karl I* was remanded to determine the fair market value of the subject property, and, on retrial, the court ruled against the lender's assertion of a "liquidation to cash equivalent" test for determining fair market value and consequential loss when the lender had credit bid, finding that, if the foreclosure had led to a third party purchase, there was no guarantee that the lender would have been paid in full. Because the court found that the fair market value of the subject property excluded the outstanding debt, no loss could be shown. *Karl v Commonwealth Land Title Ins. Co.* (1997) 60 CA4th 858, 871, 70 CR2d 374 (*Karl II*).

For the insured lender, the principal benefit of this decision is that an acquiring lender need not sell the property before it can make a claim on its title insurance policy and need not wait until resale as required by *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 275 CR 107. Note, however, that the *Karl II* court also held that the lender may not make a claim until after a foreclosure sale. On measure of damages, see §§8.42-8.45, 11.5-11.14.

PRACTICE TIP: The lender should put the title insurance company on notice of potential claims as soon as it is aware of any claims. The lender should also consider the impact of any title insurance claims when it credit bids at a foreclosure sale.

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§6.68 b. Owner

Theoretically, at least, title insurance coverage can be eternal. The title policy does not include a termination date. Transfer of all or a portion of the property by operation of law does not terminate coverage. See §6.61. In addition, certain other transfers do not automatically terminate coverage. An owner continues to be covered under Condition 2(b) of the title insurance policy in several circumstances described below.

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§6.69 (1) Partial Interest Retained

An owner can convey a partial interest in the property but maintain coverage for the interest retained, *e.g.,* a percentage of the fee interest or a life estate.

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§6.70 (2) Carryback Financing

An owner can sell the property and carry back a purchase money deed of trust and still be covered under the existing policy. Such coverage, however, does not extend to events occurring after the owner acquired the property. Typically, the buyer's policy names the carryback seller as an insured lender. This approach offers the added benefit of providing coverage through the date of the new policy, which includes coverage for the validity and priority of the new carryback deed of trust.

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§6.71 (3) Covenants of Warranty

The policy continues as long as the insured is liable under covenants of warranty made by the insured to a transferee. This language is primarily important to insureds in states where warranty deeds are commonly used.

In California, the grant deed is actually a special warranty deed containing two implied covenants of warranty. The first is that the grantor has not previously conveyed the property, and the second is that the grantor has not previously encumbered the estate except as disclosed to the transferee. CC §1113. Title companies deny coverage for claims for breach of these implied warranties because:

- The covenants were made by the grantor (and thus are matters created, suffered, assumed, or agreed to by the insured and therefore excluded from coverage by Exclusion 3(a) (see §6.41)); or
- The warranty was not made before the effective date of the policy.

PRACTICE TIP: It is unclear whether this condition covers title warranties made in the purchase agreement itself. The policy arguably covers such warranties, but placing the warranty in the deed itself is more likely to preserve title policy coverage.

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§6.72 3. Making a Claim

Conditions 3, 4, and 5 of the CLTA policy and the 1992 ALTA lender's and owner's policies, and Conditions 3, 4, 5, and 6 of the 2006 ALTA lender's and owner's policies address the requirements placed on both the title insurance company and the insured making a claim. These requirements include when and how a claim should be made, the rights and obligations of the insurer and insured, and how to file a proof of loss. See chap 12 for further discussion of making claims under the policy.

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§6.73 4. Paying a Claim

The insurer has specific options for paying or settling a claim, which are set forth in Condition 6 of the CLTA policy and the 1992 ALTA lender's and owner's policies and Condition 7 of the 2006 ALTA lender's and owner's policies. These options include paying or tendering payment of the amount of insurance or purchasing the indebtedness of the insured lender. In addition, if a third party makes a claim against the title, the title insurance company may pay or otherwise settle with parties other than the insured claimant. See *Sala v Security Title Ins. & Guar. Co.* (1938) 27 CA2d 693, 81 P2d 578.

On paying claims, see §§11.54, 12.52, 12.54-12.58.

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5. Liability

a. Determination of Liability

§6.74 (1) Measure of Damages

Condition 7 of the CLTA policy and the 1992 ALTA lender's and owner's policies and Condition 8 of the 2006 ALTA lender's and owner's policies provide the formula for damages when liability is found under the policy. With the exception of the ALTA coinsurance clause found in both the 1992 and 2006 ALTA owner's policies, the damages are calculated in the same manner under both the CLTA and ALTA policies.

The actual measure of damages for the lender and owner under the policy are based on different theories. The lender's damages are based on the lender's inability because of the defect to recover in a foreclosure the amount of the unpaid portion of the principal secured by the deed of trust as of the date of the policy (plus interest and certain expenses). The owner's damages are based on the loss of value of the property. *Overholtzer v Northern Counties Title Ins. Co.* (1953) 116 CA2d 113, 253 P2d 116. See §§11.5-11.9.

Because of the number of steps involved, a lender has more difficulty recovering under a title policy than does an owner. A lender cannot recover merely on proving that coverage exists. The lender must then foreclose and, under *Karl v Commonwealth Land Title Ins. Co.* (1993) 20 CA4th 972, 24 CR2d 912, and *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 275 CR 107, establish that there is insufficient equity in the property as a result of the covered matter. See §§8.42-8.49, 11.10-11.14. See the discussion in §11.11 of a reduction of the "liquidation to cash equivalent" holding of *Karl v Commonwealth Land Title Ins. Co.* (1997) 60 CA4th 858, 871, 70 CR2d 374 (*Karl II*), on a second appeal.

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§6.75 (2) Coinsurance if Property Is Underinsured

Condition 7(b) of the 1992 ALTA owner's policy provides a form of coinsurance when the question of underinsurance is involved. Notably, the coinsurance provision has been eliminated from the 2006 ALTA owner's policy. Condition 7(b) of the 1992 ALTA owner's policy applies when:

- On the date of the policy, the amount of insurance is less than 80 percent of the value or purchase price, whichever is less, of the insured property interest; or
- After the date of the policy, improvements are erected that increase the value of the land by at least 20 percent over the amount of insurance.

Under the circumstances described in the first bulleted item, the insurer will pay only a prorata portion of the loss in the proportion that the stated amount of insurance bears to the total value of the property on the date of the policy. Under the circumstances described in the second bulleted item, the insurer will pay only a prorata portion of the loss in the proportion that 120 percent of the amount of insurance bears to the sum of the amount of insurance and the amount expended for the improvement. These provisions apply, however, only to the portion of the loss that exceeds 10 percent of the insurance amount. The provisions do not apply to defense costs. The authors know of no cases interpreting this condition.

EXAMPLE: Assume that property valued at $100,000 is insured for $75,000, so that the insurance coverage is 75 percent of the value of the property. A title claim made against the property equals $25,000. Under the provisions described in the first bulleted item, the title insurance company will pay only $20,625 of the claim, which is 10 percent of the insurance amount ($7500) plus 75 percent of the portion of loss in excess of 10 percent of the face amount of the policy ($13,125).

In some situations, the attorney may want to have this condition eliminated by endorsement. (See §§7.86-7.87 for a discussion of the CLTA 107.2 endorsement.) For example, if consideration is not given in cash or the transfer is a gift, the amount of insurance must be agreed on by some method other than by simply using the agreed purchase price. The insurer will request a copy of an appraisal or some other reasonable indication of value. Once the amount of insurance is agreed, the attorney might request deletion of this provision to eliminate the risk of estimating, at the time of a claim, whether the amount of insurance was less than 80 percent of the value of the land on the date of the policy.

In the case of anticipated construction, the attorney should advise the insured to either purchase additional insurance on completion or purchase the full amount of the anticipated completion value on acquisition. In the latter case, the attorney should seek to have the insurer remove this provision to avoid estimating value at the time of a claim. On coinsurance generally, see §§3.11-3.14.

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§6.76 b. Apportionment

Condition 8 of the 1992 ALTA owner's policy, the apportionment provision, applies if two or more parcels are not used as a single site and a loss affects one but not all of the parcels. Neither the CLTA policy nor the 2006 ALTA owner's policy contain an apportionment provision. This gives the insured the benefit of up to the total amount of insurance for a claim on a single parcel, even though the policy covers multiple parcels not used as a single site.

Under Condition 8 of the 1992 ALTA owner's policy, any loss will be computed as if the amount of insurance is calculated pro rata based on the value of each parcel compared with the value of all parcels on the date of the policy, without reference to any subsequent improvements.

A value of the parcels may be agreed to by the title insurance company and the insured owner when the policy is issued. Typically, the insurer will seek an agreed apportionment from the insured before issuing a policy covering multiple, noncontiguous parcels. This agreed apportionment is then set forth in an endorsement. Owners may resist apportionment because one done at the time of closing may not reflect the value of the parcels in the future. For instance, the value of lots will change following development.

There does not seem to be one standard way of dealing with this issue. It is open to negotiation with the title insurance company. The parties may agree to resolve apportionment issues through arbitration, or they may agree to reapportion the coverage annually or on some other regular basis as development proceeds. Title insurance companies sometimes waive the requirement of apportionment if, even when several lots are involved, there is only one site and no cogent reason to apportion. Apportionment may be waived if, *e.g.,* four parcels consist of a ski lodge and three ski runs.

For further discussion of the endorsement, see §§7.74-7.75.

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§6.77 c. Limitation of Liability

The limitation-of-liability condition (Condition 8 of the CLTA policy and the 1992 ALTA lender's policy, and Condition 9 of the 1992 owner's policy and the 2006 lender's and owner's policies) permits the title insurance company to litigate an alleged defect or encumbrance against title to establish title as the insured. If the insurer establishes title by litigation or otherwise in a reasonably diligent manner, it is not liable for any other loss or damage. *Sala v Security Title Ins. & Guar. Co.* (1938) 27 CA2d 693, 81 P2d 578.

Interpreting an earlier version of this provision, the court in *Nebo, Inc. v Transamerica Title Ins. Co.* (1971) 21 CA3d 222, 98 CR 237, held that whether the title insurance company acted in a reasonably diligent manner to remove a title defect is a question of fact. In this case, the insured was unable to collect rents from an investment property for over three years while the insurer litigated the title defect issue. The court held that under these circumstances the insurer had not acted in a reasonably diligent manner. Although the insurer finally delivered title through acquisition of the property (after failure of the title insurance company's litigation of the title defect), the title was not what the insured had initially bargained for nor what the insurer undertook to insure, because the title ultimately received did not include the right to collect past due rents. See §11.8.

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§6.78 d. Reduction of Insurance

Condition 9(a) of the CLTA policy and the 1992 ALTA lender's policy and Condition 10 of the 1992 ALTA owner's policy and 2006 ALTA lender's and owner's policies provide that the amount of payments made under the policy reduces the policy amount. An important exception is that costs, attorney fees, and expenses do not reduce the face amount of the policy. The authors know of no cases interpreting this provision.

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§6.79 e. Liability Noncumulative

Payments received by the lender from sources other than the insurer (typically the borrower) that reduce the principal indebtedness also reduce the amount of insurance coverage in accordance with Condition 9(b) of the conditions and stipulations of the CLTA policy and the 1992 ALTA lender's policy. Endorsements are available to fit unique transactions to reduce the impact of this provision. Use of such endorsements is important when a lender has purchased title insurance for the amount of the value of the security but is owed an amount greater than the value of the security.

The 2006 ALTA lender's policy, however, deletes this condition, and thus a payment on the mortgage under the 2006 policy does not reduce the amount of insurance available to the insured lender. Thus, the lender need not request a "last-dollar" endorsement (see §6.80) when using the 2006 policy.

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§6.80 (1) Mixed Collateral

If both real and personal property serve as collateral for the obligation, the policy coverage is reduced as the principal is paid down, resulting in insufficient title coverage at the time of a later claim. This problem can be prevented by use of a "last-dollar endorsement."

EXAMPLE: Assume that the lender has made a loan of $10 million, secured by personal property (*e.g.,* equipment and inventory) valued at $5 million and real property valued at $5 million. The borrower wants to pay only for a $5 million title policy, but the lender is concerned that if the principal amount of the loan is paid down to $5 million, Condition 9(b) of the conditions and stipulations of the CLTA policy and the ALTA lender's policy will eliminate coverage under the policy. Each dollar paid down on the loan reduces the amount of insurance by one dollar. Because $5 million is still owing on the loan, the lender wants that indebtedness to be continued to be covered under the policy. If the lender obtains a last-dollar endorsement, the amount of insurance will not be reduced until the indebtedness is reduced to the amount of the insurance policy.

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§6.81 (2) Revolving Credit Loan

Reductions under a revolving credit loan raise concerns that coverage in the future may be inadequate to cover future advances. Without an endorsement, these advances and re-advances after the date of the policy will not be covered because of Conditions 8(d) (indebtedness created after the date of the policy) and 9(b) of the CLTA policy and the 1992 ALTA lender's policy and Exclusion 3(d) of these policies (matters created after the date of the policy). A revolving credit line endorsement can be used to insure that the policy amount is not reduced on payment of a specific draw on the line of credit. See §§8.11-8.12.

The exclusion regarding indebtedness created after the date of the policy was not included in the 2006 ALTA lender's policy because the covered risks in the 2006 policy do not provide coverage against loss of priority to the extent of subsequent advances.

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§6.82 f. Subrogation

The title insurance company's comprehensive right of subrogation is dealt with in Condition 12 of the CLTA policy and the 1992 and 2006 ALTA lender's policies and in Condition 13 of the 1992 and 2006 ALTA owner's policies. When the insurer has paid a claim, it has all rights of subrogation—including all rights that the insured claimant would have had. The insured claimant must allow the insurer to sue, compromise, or settle in the name of the insured. The subrogation condition also contains provisions that protect the title insurance company from noninsured obligors. For a comprehensive discussion of the insurer's subrogation rights, see §§11.123-11.126.

The most common subrogation situation involves an obligation of record owed by the seller but missed by the title company in its search. Usually the obligation is either unpaid taxes or a note secured by a deed of trust. When the unpaid obligation comes to light after close of escrow, the insurer pays the debt to make good on its policy to the buyer and then exercises its rights of subrogation to seek recovery from the seller. *Kenny v Safeco Title Ins. Co.* (1980) 113 CA3d 557, 169 CR 808. See also *American Title Co. v Anderson* (1975) 52 CA3d 255, 125 CR 24.

PRACTICE TIP: The insured must avoid doing anything to prejudice the rights to which the insurer would be subrogated. If the insured does prejudice the insurer's rights of subrogation, there will be a corresponding reduction in the insurer's obligation to indemnify. On the duty not to impair a surety's remedies, see *Union Bank v Gradsky* (1968) 265 CA2d 40, 47, 71 CR 64. Title insurers are reluctant to insure through a quitclaim deed because the absence of warranties impairs the insurer's rights of subrogation. See §6.71.

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§6.83 g. Arbitration

Condition 13 of the CLTA policy and the 1992 and 2006 ALTA lender's policies and Condition 14 of the 1992 and 2006 ALTA owner's policies provide for mandatory arbitration of claims in any policy in which the amount of the insurance does not exceed $1 million. This threshold is raised to $2 million on the 2006 ALTA lender's and owner's policies.

Under the CLTA policy and the 1992 ALTA lender's and owner's policies, the arbitration is governed by the Title Insurance Arbitration Rules of the American Arbitration Association. However, under the 2006 ALTA lender's and owner's policies, arbitration is governed by ALTA's Title Insurance Arbitration Rules. See §14.13.

The arbitration clause is broadly worded to cover all matters relating to the transaction between the parties. As discussed in §6.87, the prospective insured can usually obtain an endorsement deleting the arbitration clause or converting it to an optional rather than a mandatory provision. On arbitration procedures, see chap 14.

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§6.84 h. Limited to Contract Damages

A major claims issue under the policy is covered in Condition 14 of the CLTA policy and the 1992 and 2006 ALTA lender's policies and Condition 15 of the 1992 and 2006 ALTA owner's policies. This provision, along with complementary provisions in the commitment and preliminary report, limits the title insurance company's liability to contract damages governed by the amount of insurance purchased rather than to unlimited negligence damages. See *Siegel v Fidelity Nat'l Title Ins. Co.* (1996) 46 CA4th 1181, 54 CR2d 84. See also §13.4.

PRACTICE TIP: This issue might arise for an insured that has given a representation and warranty in a purchase agreement and then is sued in tort for failure to disclose. The title policy may not cover damages incurred by the insured as a result of this suit. An insured should be careful about making representations and warranties and confirm that they are accurate.

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III. COMPARISONS OF EARLIER AND RECENT POLICY FORMS

§6.85 A. 1970 and 1992 ALTA Lender's and Owner's Policy Forms

The ALTA revisions to the 1970 lender's and owner's policies are resisted by some lenders and owners, who continue to request policies comparable to the 1970 form policies. The provisions that have raised the greatest concern among lenders and owners include the following:

- The environmental regulation exclusion (see §6.86);
- The arbitration provision (see §6.87); and
- The creditors' rights exclusion (see §6.88).

This comparison is included here because, in addition to newer policies written to conform to the 1970 version, disputes and litigation sometimes arises under old 1970 policies still in existence. A detailed written comparison of the 1970 and 1992 ALTA lender's policy is available from ALTA. See Directory.

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§6.86 1. Environmental Regulation Exclusion

Environmental contamination and cleanup liability became a major issue in real property law in the 1970s and 1980s. Because federal and state laws tied cleanup duties directly to property owners, insureds began to file claims against title insurance policies. Title insurers denied the claims, asserting that they did not fall within the insuring clauses of title insurance and were excluded from coverage by the government regulation exclusion of the 1970 policy.

The 1992 lender's and owner's policies specifically refer to environmental protection liens as part of the government regulation exclusion of the policy (Exclusion 1(a)). This language was first added as an amendment in 1984 and became part of the new ALTA policies adopted in 1987, also added protection for the insured if the environmental protection lien was of record and not shown as an exception to coverage in the policy.

In *Lick Mill Creek Apartments v Chicago Title Ins. Co.* (1991) 231 CA3d 1654, 283 CR 231, the court rejected the insured's claim that the presence of hazardous substances on the property as of the date of policy constituted an encumbrance on title. Citing *Chicago Title Ins. Co. v Kumar* (D Mass App 1987) 506 NE2d 154, and *South Shore Bank v Stewart Title Guar. Co.* (D Mass 1988) 688 F Supp 803, aff'd without reported opinion at 867 F2d 607, the court held that the presence of hazardous substances was not an encumbrance on title but instead related to the physical condition of the property.

The *Lick Mill* court also addressed the insured's argument that the 1987 revision expressly referencing environmental regulations gave rise to a reasonable belief that the 1970 policy, which was silent on this issue, covered contamination cleanup costs. After finding that the language of the policy was unambiguous, the court noted (231 CA3d at 1665):

> Under these circumstances, we fail to see how a specific exclusion in one policy leads to a reasonable expectation of coverage in the insuring clauses of other policies.

See §§6.25, 7.17.

Title insurance companies believe that the 1987 revision added coverage for the insured because the 1970 policy excluded all government matters regardless of whether they were shown to be of record. Thus, these companies believe that the 1970 policy offers inferior coverage to the insured. Some lenders and a few owners still prefer to retain the possibility of coverage under the 1970 form than to accept the 1987 language that gave coverage for environmental protection liens, if recorded, but excluded coverage if not recorded. These insureds acknowledge that the *Lick Mill* decision rejected this argument but note that the California Supreme Court has not rendered a decision on this issue. This search for coverage is likely to continue as long as environmental liability is tied to ownership of property.

PRACTICE TIP: Some lenders who receive the 1970 policy ask for environmental lien coverage through the CLTA 110.9 endorsement (ALTA 8.1 endorsement). It is unclear whether, by doing so, the lenders then impair their claim that the 1970 policy language already provides some environmental lien coverage.

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§6.87 2. Arbitration Provision

Some insureds resist the arbitration clause added to the 1987 policies. For further discussion of arbitration, see §6.83. By its terms, the arbitration clause is limited to policies in an amount not in excess of $1 million. A prospective insured concerned about the arbitration clause can request that it be converted by endorsement (which is free) to a voluntary rather than mandatory arbitration clause or that it be eliminated altogether. See §7.33.

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§6.88 3. Creditors' Rights Exclusion

Seeking to avoid the creditors' rights exclusions, lenders may request the 1970 loan policy, which did not originally contain this exclusion. Note, however, that some title companies have added a creditors' rights exclusion to the 1970 form policies filed with the Department of Insurance. Therefore, the lender must clarify that its intent in requesting the 1970 policy is to obtain a policy without this exclusion.

Alternatively, a lender can request that the 1992 loan policy be issued with an endorsement that removes the creditors' rights exclusion. For further discussion of this exclusion, see §§6.48, 7.18-7.20, 8.32, 11.78.

PRACTICE TIP: The availability of this endorsement depends on whether the underwriting analysis determines that the transaction is subject to the risks excluded by the creditors' rights provisions. The cost of the endorsement, if available, will vary depending on the risk. When creditors' rights risks are present, the insurer will probably decline to remove the exclusion. The underwriting analysis used by the insurer to decide whether to remove the creditors' rights exclusion is discussed in §8.32.

Insurers have never agreed that the absence of a creditors' rights exclusion means that the title policy covers creditors' rights issues. Their position is that these issues do not concern title, regardless of the presence or absence of the exclusion.

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§6.89 B. 1992 and 2006 ALTA Lender's Policy Forms

Like the 1992 version, the 2006 ALTA loan policy is designed to be used as an extended coverage policy to protect lenders from loss of their security interest in property as a result of defects in title. A detailed written comparison of the 1992 and 2006 ALTA lender's policy is available from ALTA. See Directory.

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§6.90 1. Covered Risks

Attorneys who deal with first party property coverages are familiar with "Covered Causes of Loss," such as fire and flood, which are covered under the policy. The 1992 ALTA loan policy has no such name for the affirmative insuring provisions. The 2006 ALTA loan policy denotes them as "Covered Risks."

The principal difference between the 2006 and 1992 loan policies may be the positive approach to clarifying coverage that is afforded by the new policy form. The 1992 loan policy contains several exceptions to exclusions. Apparently, ALTA intended that title defects falling within an exception to an exclusion would be covered. However, some courts, applying the rule that an exception to an exclusion cannot create coverage (see, *e.g., Elysian Inv. Group v Stewart Title Guar. Co*. (2002) 105 CA4th 315, 324, 129 CR2d 372), interpreted certain coverages narrowly. The 2006 loan policy eliminates the exceptions or limitations to the exclusions, and adds former exceptions as "Covered Risks." For example, mechanics' lien coverage now appears as Covered Risk 11(a), rather than as an exception to Exclusion 6 in the 1992 policy. Further, the title industry has viewed fraud and forgery as covered even though not specifically mentioned in the 1970, 1990, or 1992 loan policies. The 2006 loan policy specifies that "fraud" and "forgery" are covered risks. See App J, Covered Risk 2(a)(i).

As a result, the 2006 loan policy contains 14 covered risks, compared to only eight in the 1992 loan policy.

NOTE: Some title companies included an insuring clause that in substance is the same as the ALTA form 1 endorsement for street assessments, resulting in nine covered risks in the 1992 loan policy rather than eight. See App I.

The covered risks in the 2006 loan policy are:

1. Title vested other than as stated in Schedule A (see §6.22);
2. Any defect in or lien or encumbrance on title (see §6.23);
3. Unmarketable title (see §§6.24-6.26);
4. No right of access (see §6.27);
5. Violation or enforcement of police power laws, ordinances, permits, and regulations relating to building and zoning, subdivisions, and environmental protection, if notice of violation or intention to enforce is recorded in the public record (see §6.36);
6. Enforcement of police powers other than those noted in Covered Risk 5, if notice of enforcement appears in the public records (see §6.37);
7. Exercise of eminent domain power, if notice of exercise is recorded in the public records (see §6.39);
8. Prior taking by a governmental body that is binding on a bona fide purchaser for value and without notice (see §6.39);
9. Invalidity or unenforceability of the lien of the insured mortgage (see §6.28);
10. Lack of priority of the lien of the insured mortgage over any other lien or encumbrance (see §6.29);
11. Mechanics' lien and special assessment coverage (see §§6.30, 6.31);
12. Assignment (see §6.32);
13. Creditors' rights coverage (see §6.48 for discussion of exception to exclusion under 1992 policy); and
14. Post-policy or "gap" coverage (see §6.97).

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§6.91 2. Exclusions

The 2006 ALTA loan policy contains seven exclusions, the same number as in the 1992 loan policy. However, the 2006 policy does not include Exclusion 6 of the 1992 policy (regarding statutory liens for services, labor, or materials arising from an improvement or work related to the land that is contracted for and begun after the date of the policy, discussed in §6.47), but does include an exclusion not found in the 1992 policy (Exclusion 7, regarding liens for real estate taxes or assessments imposed by governmental authority during the "gap"). The exclusions in the 2006 loan policy are:

1. Police power laws, ordinances, permits, or regulations relating to building and zoning, subdivisions, and environmental protection or the effect of violation thereof (see §§6.35-6.38);
2. Eminent domain (pending or prior) (see §6.39);
3. Bona fide purchaser status (see §§6.40-6.45);
4. Doing business laws (see §6.46);
5. Usury, consumer credit protection, and truth-in-lending laws (see §6.46);
6. Creditors' rights (see §§6.46-6.48); and
7. Taxes and special assessments in the "gap" (see §6.97).

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§6.92 3. Arbitration

The threshold below which either the insured or the insurer can require the other to submit to binding arbitration has been increased from $1,000,000 in the 1992 policy to $2,000,000 in the 2006 policy. In addition, the 2006 loan policy states that the arbitration is to be conducted pursuant to the ALTA Title Insurance Arbitration Rules as opposed to those of the American Arbitration Association (AAA). Further, the 2006 loan policy makes clear that, except as provided in ALTA's Title Insurance Arbitration Rules, there can be no joinder or consolidation with claims or controversies of other persons. On arbitration procedures, see chap 14.

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§6.93 4. Proof of Loss

The 2006 loan policy eliminates the requirement in the 1992 loan policy that the insured claimant always provide a proof of loss. See §§12.16-12.23. Instead, the insurer must first attempt to determine the loss and, if it is unable to do so, it may require the insured claimant to furnish a signed proof of loss. The remedy stated in the 1992 policy for failing to provide a proof of loss, terminating the insured claimant's rights, was removed. See §12.23. However, implicit in the 2006 loan policy is the right of the insurer to withhold payment under the policy until the insured claimant furnishes a signed proof of loss if requested to do so by the insurer. See App J, Condition 4.

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§6.94 5. Expanded Definition of "Insured"

The definition of "Insured" has been expanded. The definition adds as an insured successors in ownership of the indebtedness, whether the successor owns the indebtedness for its own account or as a trustee or fiduciary. The term "Insured" has also been expanded to include the successor to an insured on conversion to a different kind of entity. Further, the term "Insured" now includes the grantee in a deed executed by the named insured and delivered for no consideration if the grantee (1) is wholly owned by the named insured, (2) wholly owns the named insured, or (3) is wholly owned by an affiliated entity of the named insured, provided the affiliated entity and the named insured are both wholly owned by the same person or entity. Finally, the definition of "Insured" also includes the person or entity who has "control" of the "transferable record," if the indebtedness is evidenced by a transferable record as defined by applicable electronic transaction law; this includes third parties, such as MERS (Mortgage Electronic Registration System) or other service providers, even though the third party may not be named when an electronic transaction is involved. See Com C §7106.

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§6.95 6. New Definition of "Indebtedness"

The 2006 ALTA loan policy adds "Indebtedness" to its list of defined terms. "Indebtedness" is defined as the obligation secured by the insured mortgage. If the obligation is the payment of a debt, then "Indebtedness" includes:

- Principal disbursed as of the date of the policy;
- Principal disbursed subsequent to the date of the policy;
- Construction loan advances made subsequent to the date of the policy;
- Interest;
- Prepayment premiums, exit fees, and other similar fees and penalties permitted by law;
- Expenses of foreclosure and other costs of enforcement;
- Advances to assure compliance with law or to protect the priority of the insured mortgage prior to acquisition of title;
- Advances to pay taxes and insurance; and
- Reasonable amounts advanced to prevent deterioration of improvements to the land.

In measuring loss, these amounts will be reduced by the total of all payments received by the insured and by the amount forgiven by the insured. It would appear that the second and third items on this list are included solely for the purpose of measuring loss, because the 2006 loan policy does not insure the validity, enforceability, or priority of subsequent advances unless they fall within the insuring provision of Covered Risk 11 or ALTA Endorsement Form 14.

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§6.96 7. Increase Regarding Extent of Liability

Condition 8(b)(i) of the 2006 ALTA loan policy provides for a 10 percent increase in the amount of insurance if the insurer pursues its rights to defend or prosecute an action to establish title and is unsuccessful. Condition 8(b)(ii) gives the insured the choice of having the loss or damage determined as of either the date the claim was made or the date it is settled and paid. These provisions are new to the 2006 policy.

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§6.97 8. Post-Policy or "Gap" Coverage

Covered Risk 14, post-policy or "gap coverage," applies only to title operations that issue final policies showing the date of the policy as the closing date. It does not apply if the final policy shows the date of the policy as the recording date. On date of policy, see §8.47; on priority of deed of trust and recordation, see §8.13. This provision is designed to protect the insured against loss arising from defects falling within Covered Risks 1 through 13 that are created, attach, or are recorded in the public records between the date of the policy and the recording date of the insured mortgage.

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§6.98 C. 1992 and 2006 ALTA Owner's Policy Forms

Like the 1992 version, the 2006 ALTA owner's policy is designed as an extended coverage policy. It may also be used as a standard coverage policy by adding the preprinted Western Regional Exceptions (see §§6.5, 6.8). A detailed written comparison of the 1992 and 2006 ALTA lender's policy is available from ALTA. See Directory.

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§6.99 1. Covered Risks

Like the 2006 ALTA loan policy, the 2006 ALTA owner's policy denotes the insuring provisions as "Covered Risks," eliminates the exceptions or limitations to the exclusions, and adds the former exceptions to "Covered Risks." In addition, the 2006 owner's policy specifies fraud and forgery as covered risks. See App L, Covered Risk 2(a)(i). As a result, the 2006 owner's policy contains ten covered risks, compared to only four in the 1992 owner's policy. The 2006 policy covered risks are:

1. Title vested other than as stated in Schedule A (see §6.22);
2. Any defect in or lien or encumbrance on title (see §6.23);
3. Unmarketability of title (see §§6.24-6.26);
4. Lack of right of access (see §6.27);
5. Enforcement of police power laws, ordinances, permits, and regulations relating to building and zoning, subdivisions, and environmental protection, if notice of violation or intention to enforce is recorded in the public record (see §6.36);
6. Enforcement of police powers other than those noted in Covered Risk 5, if notice of enforcement appears in the public records (see §6.37);
7. Pending exercise of eminent domain power, if notice of exercise is recorded in the public records (see §6.39);
8. Prior taking by a governmental body that is binding on a bona fide purchaser for value and without notice (see §6.39);
9. Creditors' rights coverage (see §6.48); and
10. Post-policy coverage (see §7.35G).

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§6.100 2. Exclusions

The 2006 owner's policy contains five exclusions, compared to four in the 1992 owner's policy. The 2006 policy contains exclusions for:

1. Police power laws, ordinances, permits, or regulations relating to building and zoning, subdivisions, and environmental protection or the effect of violation of such laws, ordinances, permits, or regulations (see §§6.35-6.38);
2. Eminent domain (pending or prior) (see §6.39);
3. Bona fide purchaser status (see §§6.40-6.45);
4. Creditors' rights (see §6.48); and
5. Taxes and special assessments in the "gap" (see §7.35G).

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§6.101 3. Arbitration

Like the 2006 ALTA loan policy, the 2006 ALTA owner's policy increased the threshold below which either the insured or the insurer can require the other to submit to binding arbitration from $1,000,000 in the 1992 policy to $2,000,000 in the 2006 policy. In addition, the 2006 owner's policy states that the arbitration is to be conducted pursuant to the ALTA Title Insurance Arbitration Rules, as opposed to those of the American Arbitration Association (AAA). Condition 14 of the 2006 owner's policy makes clear that, except as provided in ALTA's Title Insurance Arbitration Rules, there can be no joinder or consolidation with claims or controversies of other persons. On arbitration procedures, see chap 14.

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§6.102 4. Proof of Loss

Like the 2006 loan policy, the 2006 owner's policy eliminates the requirement that the insured claimant always provide a proof of loss (Condition 4). See §§12.16-12.23. Instead, the insurer must first attempt to determine the loss and, if it is unable to do so, may require the insured claimant to furnish a signed proof of loss. The remedy stated in the 1992 policy for failing to provide a proof of loss, terminating the insured claimant's rights, was removed. See §12.23. However, implicit in Condition 4 is the right of the insurer to withhold payment under the policy until the insured claimant furnishes a signed proof of loss if requested to do so by the insurer. See App L, Condition 4.

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§6.103 5. Expanded Definition of "Insured"

Unlike the 1992 and earlier owner's policies, the definition of "Insured" in the 2006 owner's policy includes the trustee or beneficiary of a trust created by the named insured for estate planning purposes.

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§6.104 6. Increase Regarding Extent of Liability

Condition 8(b)(i) of the 2006 ALTA owner's policy provides for a 10-percent increase in the amount of insurance if the insurer pursues its rights to defend or prosecute an action to establish title and is unsuccessful. Condition 8(b)(ii) gives the insured the choice of having the loss or damage determined as of either the date the claim was made or the date it is settled and paid. These provisions are new to the 2006 policy. Further, the coinsurance provision found in the 1992 ALTA owner's policy (Condition 7(b)) has been eliminated.

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7

Owner's Policies and Endorsements

James T. Straw

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VI. POSTCLOSING REVIEW §7.104

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§7.1 I. REASONS TO OBTAIN OWNER'S TITLE POLICY

The fundamental structure of the most commonly used title insurance policy forms, including the policies' basic coverages, exclusions, exceptions, and conditions and stipulations, are thoroughly covered in chap 6. This chapter discusses policies and endorsements that insure an owner of a fee, leasehold, or other estate. It is essential in any purchase transaction to consider the buyer's need for a separate owner's policy of title insurance. For a one-time policy fee, the owner is indemnified for as long as the owner holds title to the property. The original policy coverage continues:

- As long as the owner retains a partial interest in the property (see §6.69);
- After a sale if the owner carries back a deed of trust (see §6.70); and
- When the owner remains liable under certain covenants of warranty (see §6.71).

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§7.2 A. Distinguishing Other Title Products

Prospective owners may believe that they can reduce closing costs by relying on a preliminary report or by obtaining a policy insuring only the lender and forgoing a separate owner's policy. An owner's attorney must beware of misplaced reliance on title insurance company products issued for purposes other than insuring the owner and should advise the owner on both the dangers of not having title insurance and the risks of relying on other title products.

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§7.3 1. Preliminary Report

An owner does not receive any title insurance by obtaining a preliminary report, which is only an *offer* to issue insurance. It is not a representation of the state of title, and the title company does not assume an abstractor's liability by issuing a preliminary report. On preliminary reports generally, see chap 5. On the lack of liability for issuance of a preliminary report, see §§5.25-5.28, 11.44. See also §3.14.

California courts imposed "abstractor's negligence" liability on preliminary reports issued before 1982. *White v Western Title Ins. Co.* (1985) 40 C3d 870, 884, 221 CR 509. Insurance Code §§12340.10-12340.11 made it clear that a preliminary report issued after 1982 is only a contractual precursor to the policy, and no abstractor's liability applies. See Ins C §12340.11 and cases following its effective date such as *Southland Title Corp. v Superior Court* (1991) 231 CA3d 530, 537, 282 CR 425, and *Fidelity Nat'l Title Ins. Co. v Miller* (1989) 215 CA3d 1163, 1175, 264 CR 17. See §11.43.

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§7.4 2. Lender's Policy

An owner cannot rely on the coverage provided in a separate policy issued to an insured lender. An ALTA policy issued to the lender does not insure the owner against losses from title defects. *Walters v Marler* (1978) 83 CA3d 1, 147 CR 655, disapproved on other grounds in 35 C3d at 506. Nor does issuance of a lender's policy constitute an undertaking by the title insurance company to insure the owner. See *Siegel v Fidelity Nat'l Title Ins. Co.* (1996) 46 CA4th 1181, 1186 n3, 54 CR2d 84. On ALTA lender's policy generally, see chaps 6, 8.

PRACTICE TIP: The buyer at a foreclosure sale should obtain an owner's policy even if the buyer is a foreclosing lender with a lender's policy. See §8.48. One reason to do so is that an insured owner's loss because of a title defect is measured differently from that of an insured lender. *Karl v Commonwealth Land Title Ins. Co.* (1993) 20 CA4th 972, 24 CR2d 912 (*Karl I*); *Karl v Commonwealth Land Title Ins. Co.* (1997) 60 CA4th 858, 871, 70 CR2d 374 (*Karl II*). If the lender acquires the property at a foreclosure sale, the lender's policy is not converted into an owner's policy for purposes of ascertaining the amount of that loss. *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 426, 275 CR 107. A new owner's policy is needed. On lender's measure of damages, see §§8.42-8.45, 11.10-11.14.

For further discussion of reasons for the foreclosing lender to obtain an owner's policy, see §§6.65-6.67.

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§7.5 3. Trustee's Sale Guaranty

The trustee's sale guaranty is designed to provide the trustee conducting a nonjudicial foreclosure with the information necessary to notify the owner and junior beneficiaries of the proposed sale of the property. It is not a title policy and, based on the reasoning of *Walters v Marler* (1978) 83 CA3d 1, 147 CR 655, disapproved on other grounds in 35 C3d at 506, may not be relied on by a purchaser at a foreclosure sale. Guaranties are not substitutes for title insurance policies. On trustee's sale guaranty generally, see §§9.6-9.8.

PRACTICE TIP: Unfortunately, there may be little the buyer at a trustee's sale can rely on besides the trustee's sale guaranty. Prior to the sale, a prospective bidder would have to purchase a preliminary report, which can be costly and, because it is not a representation of title, cannot be relied on. See §§5.1, 5.4. The prospective bidder may be able to obtain a commitment, although many title insurance companies will not issue one. If the bidder can obtain one, he or she should try to get the title insurance company to agree to offset the cost of the commitment against the premium for the title policy. One drawback to this approach is that a prospective bidder who pays for a commitment may not be the successful bidder at the sale. If no commitment is available or obtained, the successful bidder could still obtain an owner's policy, but at this point, the property will have been acquired and the owner will have little bargaining power to negotiate with the title insurance company to remove exceptions or issue endorsements.

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§7.6 B. No Duty to Issue Title Policy

Title insurance is considered integral to most property transactions in California. Because a title policy is only a contract of indemnification, not a representation of the state of title (see §6.2), a title insurance company may establish which risks it will insure. To date, the courts have not imposed on title insurance companies any duty to issue a title policy. The California Supreme Court addressed this issue in *Quelimane Co. v Stewart Title Guar. Co.* (1998) 19 C4th 26, 77 CR2d 709, holding that, although title insurance coverage was refused for a tax-defaulted property by multiple title companies, the plaintiff had stated a cause of action for unfair competition and intentional interference with contractual relations under the circumstances presented in that case. Title companies are not required to issue particular types of insurance. 19 C4th at 43.

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C. Counseling Owners on Policy Matters

§7.7 1. Ascertaining Coverage and Reviewing Preliminary Report

Counsel should advise the buyer on the types of coverage available and which coverage would best meet the buyer's needs. Preliminary reports, commitments, and binders help counsel to ascertain the scope of coverage before closing. On preliminary reports, see §§5.1-5.30; on binders, see §§3.20-3.22; on commitments, see §§5.31-5.38. Before closing a large commercial transaction, buyer's counsel may require that the title company provide a pro forma policy to confirm the exact nature and terms of the final title policy. On pro forma policies, see §10.11.

Once a preliminary report, pro forma policy, commitment, or binder is issued, counsel should advise the purchaser of the importance of reviewing and evaluating:

- The Schedule B typewritten exceptions; and
- The copies of the recorded documents, surveys, and any off-record documents referred to in the typewritten exceptions, before the client approves their integration as exceptions into the title policy.

On counsel's role in determining coverage generally, see §§2.15-2.20.

PRACTICE TIP: Actual review of such documents before closing is recommended in any acquisition of title, but in some transactions (*e.g.*, simple residential purchases) the client may be reluctant to incur the cost of counsel's conducting a document review. The client may decide that a thorough review is unnecessary because of the nature of the property, because of his or her familiarity with the history of the property, or because the client does not contemplate new construction. On the role of buyer's attorney generally, see §§2.4-2.39; on exceptions to coverage, see §§5.9-5.19.

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§7.8 2. Preparing Instructions on Title Insurance Coverage

Before closing, counsel should prepare title instructions specifying the form of policy to be issued, the approved exceptions (usually by reference to the preliminary report), and any necessary endorsements. On title instructions, see §§10.15-10.17.

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§7.9 3. Disclosing Known Title Matters

If before close of escrow a seller discloses to the purchaser documents affecting title, whether recorded or unrecorded, the buyer must in turn disclose them to the title insurer. If the insurer is not advised in advance of title matters disclosed to the purchaser, such as off-record leases or other interests not shown in the preliminary report, the title insurance company may deny a subsequent title policy claim arising from these undisclosed documents based on exclusion 3(a) for matters "whether or not recorded… but created, suffered, assumed or agreed to by the insured claimant" or exclusion 3(b) for matters "known to the insured claimant and not disclosed in writing to the Company" before the date of the policy. See §§6.40-6.42.

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§7.10 4. Explaining Date-Down Matters

There is always a gap period between the date the title company issues a preliminary report, pro forma policy, commitment, or binder and the closing date, when the policy is issued. Generally, the pro forma policy, preliminary report, binder, or commitment excludes new matters recorded or arising during the gap period. Just before the close of escrow a title company usually dates down the policy, adding any new matters found since issuance of the pro forma policy, preliminary report, binder, or commitment. Counsel should explain to the prospective owner that any date-down matters left unresolved will be shown as an exception to the policy. Counsel may need to determine quickly if these items are acceptable to the new owner and the lender. Actual review of the documents may be essential to confirm how they affect the transaction and the parties.

PRACTICE TIP: In a commercial transaction, the purchase agreement and the buyer's escrow instructions usually state how title will be delivered. New exceptions to title are not permitted. Consequently, if new exceptions are discovered, the seller may need to take appropriate action to remove them if the transaction is to proceed.

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§7.11 II. COMPARING EARLIER AND RECENT OWNER'S POLICIES

The title industry has standardized title policy provisions through the California Land Title Association (CLTA) and the American Land Title Association (ALTA), which develop and publish the most widely used forms. The 1990 CLTA standard coverage policy (CLTA policy), the 1992 ALTA extended coverage owner's policy, and the 2006 ALTA owner's policy are analyzed at length in chap 6. The following discussion highlights some major differences between these policies, which counsel for a prospective owner should consider if asked to advise on the difference between the CLTA policy and the 1992 or 2006 ALTA extended coverage owner's policy. For a copy of the CLTA policy, see App H; for a copy of the 1992 ALTA owner's policy, see App K; for a copy of the 2006 ALTA owner's policy, see App L.

Both the 1992 and the 2006 ALTA extended coverage owner's policies can be converted for use as a standard coverage policy (ALTA standard coverage owner's policy), which becomes comparable to the CLTA policy by the addition of preprinted exceptions, referred to as "standard exceptions" or as the "Western Regional Exceptions." This book uses the latter. The 1992 ALTA standard coverage owner's policy is seldom used in California; presumably, the same will be true for the 2006 ALTA owner's policy.

Some owners still request the previous version of the CLTA policy and the ALTA extended coverage policy. The reasons for this are discussed in §§6.85-6.88, 7.17, 7.19.

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A. 1990 CLTA Policy Compared to 1992 and 2006 ALTA Owner's Policies

§7.12 1. Summary of Basic Coverage

An owner is covered for the following four matters by both the CLTA policy and the 1992 and 2006 ALTA extended and standard coverage owner's policies:

- Title to the estate or interest vested other than as described in Schedule A (see §6.22);
- Any defect in, or lien or encumbrance on, the title (see §6.23);
- Unmarketable title (see §§6.24-6.26); and
- No right of access to and from the land (see §6.27).

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§7.13 a. Access

The current form CLTA policy and the 1992 ALTA extended and standard coverage owner's policies insure against a "lack of a right of access" to and from the land. The 2006 ALTA policies insure against "no right of access" to and from the land. Before 1990, the CLTA owner's policy provided coverage for "rights of an abutting owner, if the land in fact abutted a physically open street." This phrase meant that the insured property could be landlocked and the policy would not cover any resulting loss. In contrast, current policy forms cover access to property that lies one or more lots removed from a street and that relies on easements over the intervening land.

To obtain insurance of a specific access route, a CLTA 103.4 or 103.7 endorsement is required. See §6.27. On available endorsements, see §§7.72-7.73.

PRACTICE TIP: If the access easement is a nonexclusive easement that includes conditions or restrictions in connection with the easement, Schedule A of the CLTA policy and of both the ALTA extended and standard coverage owner's policies will refer to the use of the easement while Schedule B will list it as an exception because of third party rights over the easement.

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§7.14 b. No Express Coverage of Mechanics' Liens

Unlike the ALTA loan policies (ALTA lender's policies), neither the CLTA policy nor the 1992 and 2006 ALTA extended and standard coverage owner's policies expressly insure against mechanics' liens under their insuring clauses. On lender's policy coverage of mechanics' liens, see §6.30. A mechanics' lien may be covered under an ALTA extended coverage owner's policy when the lien was recorded after the date of the policy but the seller began the work before that date. Whether such liens are covered depends on whether they are excluded as matters either created, suffered, assumed, or agreed to by the insured (see §6.41), or are known by the insured and not disclosed in writing to the title insurance company (see §6.42). Endorsements are available for coverage of mechanics' liens. See §§7.88-7.89.

PRACTICE TIP: Assume that a mechanics' lien is recorded after the date of the policy for a work of improvement completed before the sale and not paid for by the prior owner. Under the "record-title" coverage of the CLTA owner's policy and the 1992 and 2006 ALTA standard coverage owner's policy, the claim would not be covered, because it is an "off-record" inchoate claim of the future mechanics' lien. To obtain coverage under these policies, some record notice is required (*e.g.,* recorded mechanics' lien, notice of completion, notice of cessation, or notice of nonresponsibility).

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§7.15 2. CLTA Joint Protection Policy

In addition to the basic coverage described in §7.12, the CLTA policy can be issued as a joint protection policy, insuring both the owner and the lender in one policy. The CLTA policy also covers the insured lender for the following three matters:

- Invalidity or unenforceability of the lien of the insured mortgage on the title (see §6.28);
- Priority of the lien or encumbrance over the lien of the insured mortgage, which is shown in Schedule B in the order of its priority (see §6.29); and
- Invalidity or unenforceability of the assignment of the insured mortgage, as long as the assignment is shown in Schedule B, or the failure of the assignment shown in Schedule B to vest title to the insured mortgage in the name of the insured assignee free and clear of all liens (see §6.32).

This joint protection format is typically used for seller carry-back loans. Most institutional lenders require the extended coverage of the ALTA lender's policy. The joint protection policy is cost effective for the owner if, as usually occurs, the owner is paying for the lender's coverage because the lender's insurance is provided for a minimum charge above the premium paid for the owner's policy. For further discussion of CLTA joint protection policies, see §6.7.

The joint protection policy's coverage liability is not cumulative for the owner and lender. Condition 10 of the CLTA policy provides that a policy loss paid to any Schedule B lender reduces the amount of coverage under the owner's policy. Thus, the owner must treat the lender's coverage amount as coincident with its own coverage amount.

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§7.16 3. Summary of Exclusions

The exclusions listed in the CLTA policy, and in the 1992 ALTA extended and standard coverage owner's policies, are substantially similar, but there are a few important differences. Exclusion 3(a) of the CLTA and 1992 policies excludes "defects, liens, encumbrances, adverse claims or other matters" that are "created, suffered, assumed or agreed to by the insured claimant." The CLTA owner's policy adds as a clarification that this exclusion applies "whether or not recorded in the public records at the date of the policy." See §§6.41, 11.71.

Because the CLTA policy may be issued as a joint protection policy, it contains specified exclusions for the invalidity of an insured lien owing to failure to comply with applicable doing-business laws (Exclusion 4) and usury, consumer credit, and truth-in-lending laws (Exclusion 5). On these two exclusions, see §6.46.

On exclusions to the CLTA policy and the 1992 and 2006 ALTA policies generally, see §§6.34-6.48.

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§7.17 a. Environmental Liens

Exclusion 1(a) of the 1992 and 2006 ALTA extended and standard coverage owner's policies specifically excludes environmental liens unless a notice of their existence is recorded in the public records. Because earlier versions of the ALTA owner's policies did not mention environmental liens, some attorneys argue that these older forms covered environmental liens because they were not expressly excluded. The court rejected that argument in *Lick Mill Creek Apartments v Chicago Title Ins. Co.* (1991) 231 CA3d 1654, 283 CR 231. Title insurance companies argue that the old policy forms did not cover liens, and the new form now provides some protection. For further discussion of environmental liens, see §§6.25, 6.86.

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§7.18 b. Creditors' Rights Exclusion

The CLTA policy and the 1992 and 2006 ALTA extended and standard coverage owner's policies each exclude certain matters arising from the insured's vesting transaction because of the operation of state insolvency or federal bankruptcy laws. The creditors' rights exclusion in the CLTA policy (Exclusion 6) excludes all claims arising under federal bankruptcy, state insolvency, or similar credit laws. The creditors' rights exclusion of the 1992 ALTA owner's policies (Exclusions 4(a) and 4(b)) excludes claims based on fraudulent or preferential transfers unless the preferential transfer claim results from either (1) the failure to timely record the instrument of transfer or (2) the failure of such recordation to impart notice to a purchaser for value or a judgment or lien creditor, while the 2006 policy excludes all claims based on fraudulent or preferential transfer regardless of timely recordation or notice.

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§7.19 (1) Avoiding Creditors' Rights Exclusion by Using Pre-1990 Policy Form

Before 1990, the CLTA policy and the ALTA owner's policies did not include a creditors' rights exclusion. Some owners still use the older form owner's policies to avoid the creditors' rights exclusion.

PRACTICE TIP: Most title insurance companies take the position that the older policies did not cover losses from matters described in the creditors' rights exclusion, because these matters are not title matters. Thus, they assert that the creditors' rights exclusion in the new policies merely expresses the intent of the older policies. Using the older policies, therefore, may not mean that these matters are covered. The author is not aware of any California case on this issue, but see *Chicago Title Ins. Co. v Citizens & S. Nat'l Bank* (ND Ga 1993) 821 F Supp 1492.

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§7.20 (2) Endorsing Over Creditors' Rights Exclusion

An owner can request a special endorsement eliminating the creditors' rights exclusion. This option may become more prevalent as title insurance companies discontinue the older policy forms.

Before agreeing to endorse over the exclusion, the title insurance company will require evidence that the transaction is an arm's-length sale to a third party for fair market value.

PRACTICE TIP: In a residential transaction, the use of a broker and a multiple listing service is evidence that the sale of the property was subject to the open market.

If unable to show that the transaction is such an arm's-length sale, the insured may have to convince the title insurer that there is no chance of bankruptcy or any other insolvency proceeding. See §§6.48, 6.88, 8.32 for further discussion of creditors' rights exclusion.

PRACTICE TIP: Because of the highly competitive nature of title insurance, some attorneys have reported success in getting this exclusion removed by making it an item of competition among title insurance companies.

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4. Preprinted and Regional Exceptions

§7.21 a. Summary of Preprinted Exceptions

The real distinctions between the CLTA policy and the 1992 and 2006 ALTA extended coverage owner's policy arise in the Schedule B exceptions. See §§6.50-6.54. The CLTA policy excepts from coverage the following:

- Taxes, assessments, and certain tax proceedings not shown as existing liens;
- Certain facts, rights, interests, or claims not shown by public records but that could be ascertained by an inspection or by persons in possession of the land;
- Easements, liens, or encumbrances not shown by the public records;
- Certain specified matters, including conflicts in boundary lines, shortages in area, and facts that a correct survey would disclose but are not shown by the public records; and
- Unpatented mining claims, reservations or exceptions in patents, and water rights—whether or not shown by the public records.

The 1992 and 2006 ALTA extended coverage owner's policy does not include these exceptions. By adding these exceptions (known as the Western Regional Exceptions; see §§6.5, 6.8) to the ALTA extended coverage owner's policy, a standard coverage policy is created (ALTA standard coverage owner's policy), which provides coverage comparable to that in the CLTA policy. The ALTA standard coverage owner's policy is seldom used in California.

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b. Standard Coverage Policy

§7.22 (1) Record Title Policy

In California, the CLTA policy is the staple of the title business for owner's coverage, especially for residential transactions. The CLTA policy (and the ALTA standard coverage owner's policy) is a standard coverage policy that generally covers matters disclosed in the public records and not expressly excepted or excluded from coverage. See §§6.7, 6.51. On definition of public records, see §§6.62, 7.31.

The key point of a standard coverage policy is that it requires only a search of the matters "of record" that impart constructive notice to the insured. *Rice v Taylor* (1934) 220 C 629, 633, 32 P2d 381.

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§7.23 (2) Transactional Validity: Fraud, Forgery, or Failure of Delivery

Claims relating to transactional validity, such as fraud, forgery, or failure of delivery, are not expressly covered by the CLTA policy or the 1992 ALTA owner's policies. These claims may be covered by implication based on the fact that the title policy insures the validity of the deed to an owner (or deed of trust for the lender). Thus, any attack on the validity of the deed (or the deed of trust) through an alleged fraud, forgery, or lack of valid delivery is covered under the clauses that insure vesting of the insured and marketability of the title, absent an express exception. See California Insurance Law & Practice §§39.05, 39.40[7] (2001). This insurance of the transactional validity of the insuring documents is a significant and understated reason for obtaining an owner's title insurance policy.

The 2006 ALTA owner's policy includes fraud and forgery as covered risks (see App L, Covered Risks 2(a)(i)). Likewise, the ALTA residential policy expressly insures against loss by fraud, forgery, and lack of delivery; see §7.39, App M.

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§7.24 c. Extended Coverage Policy

The absence of the five preprinted exceptions described in §7.21 creates the broad coverage benefits of the 1992 and 2006 ALTA extended coverage owner's policies. They insure certain "off-record" matters, including those shown on surveys, encroachments, or other nonrecord matters. See §§6.10-6.11, 6.54. (If Schedule B of an ALTA owner's policy form includes the five preprinted exceptions to coverage listed in §7.21, the extended coverage policy is converted into an ALTA standard coverage owner's policy with coverage comparable to the CLTA owner's policy.)

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§7.25 (1) Survey Requirement

Surveys are frequently required for issuance of an ALTA extended coverage owner's policy. The title insurer will review the survey before issuing a policy and may add separate Schedule B exceptions for specific matters disclosed by the survey, such as an encroachment or off-record easement. Most title insurance companies require that the survey be prepared in accordance with the standards established in 1992 by ALTA and the American Congress on Surveying and Mapping (ACSM). On the ALTA/ACSM Land Title Survey standards generally, see §4.32.

PRACTICE TIP: The ALTA extended owner's policy may be available even if the survey conforms with some but not all of the ALTA/ACSM Land Title Standards. This issue is negotiable with the insurer.

The cost of a survey and the time for its preparation may adversely affect the cost effectiveness of a transaction. See §§2.18, 7.26. On surveys generally, see §§4.30-4.34.

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§7.26 (2) Commercial and Residential Use of Survey Compared

Unlike residential buyers, commercial developers and owners often obtain a survey for their own planning purposes or to fulfill due diligence or loan commitment requirements. In this situation, the survey cost is a not an issue. Residential buyers, however, may find the survey cost prohibitive and otherwise unnecessary. In a residential lot and block subdivision, the benefits of a survey may not outweigh the cost if the risk of a survey defect is minimal, especially if the rights of the property owners have been established over a lengthy period of time (preferably the applicable statute of limitations). Counsel should explain to the buyer that a transaction involving raw land, new construction, or property not previously insured, surveyed, or subdivided, may require an ALTA extended coverage owner's policy to confirm boundaries and to locate any unrecorded easements and encroachments. See §§2.15-2.20 on attorney's role in explaining coverage. See §§7.11-7.35, 6.7-6.10 on differences between the ALTA extended coverage owner's policy and the CLTA policy.

EXAMPLE: The client's plans for the property may dictate whether a survey is needed. The effect of potential claims on the use and value of a vacant lot will vary considerably, depending on whether the client proposes to construct a parking lot or an office building. A two-foot survey discrepancy, such as a setback violation or a structural encroachment, may affect the use and value of a developed urban lot but not affect those of a large agricultural tract.

If using funds from an institutional lender, the owner will probably be required to pay for the lender's ALTA extended coverage policy. If the client is either willing or required to obtain a survey and is willing to pay the extra policy charge, the ALTA extended coverage owner's policy expands coverage to include certain off-record matters. See §§6.8, 6.54, 7.24. This is important to the insured with respect to claims based on such off-record matters. These matters may be difficult to evaluate because there are no record documents to review, and an inspection of the property by a broker, a buyer, or counsel may not reveal off-record flaws created by a predecessor in title or its contractors.

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§7.27 5. Typewritten Exceptions (Schedule B Exceptions)

Typewritten exceptions (in Schedule B of the CLTA policy and the 1992 and 2006 ALTA extended and standard coverage owners' policies) relate to the insured property and the proposed transaction. The ALTA extended coverage owner's policy lists as exceptions certain off-record matters (*e.g.*, those disclosed by a survey).

NOTE: Some underwriters do not disclose off-record matters on the CLTA policy (or the ALTA standard coverage owner's policy), because the policy is designed to list only items actually shown in the public records as exceptions. These underwriters are concerned that, if an unrecorded item were listed as an exception, the insured might erroneously conclude that there are no other unrecorded matters affecting the insured property. Other underwriters will except specific unrecorded items from the policy if they are known.

See also §§6.55-6.57.

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§7.28 6. Conditions and Stipulations

To adequately inform the client on policy issues, counsel must be aware of some of the significant terms and conditions in the policy's conditions and stipulations. Although many of the conditions and stipulations become important only in a claims setting, some of the definitions and provisions discussed in §§7.29-7.33 are necessary to properly evaluate the scope of coverage. For example, it is important to understand the meaning of the term "insured" when deciding whether a particular partnership or corporate transaction requires issuance of a new policy or merely an endorsement to the existing policy. On conditions and stipulations generally, see §§6.58-6.84.

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a. Important Definitions

§7.29 (1) Insured

The definition of an insured in Condition 1(a) is similar in the CLTA policy and the 1992 ALTA owner's policies. The term "insured" includes not only the insured named in Schedule A, but also its successors by operation of law, subject to the defenses of the insurer. (Although the CLTA policy, because it is a joint protection policy, adds to the definition of insured, those who may succeed to the rights of the insured lender—including a foreclosing lender—the foreclosure does not convert the lender's policy into an owner's policy. See *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 275 CR 107. On need for separate owner's policy, see §§6.64-6.67, 7.4, 8.48.)

The vesting clause of Schedule A should identify the legal entity or person actually vested in title. However, the name of the actual insured may differ from the vestee if, for example, only one of several cotenants obtains a title insurance policy. See also §6.61.

PRACTICE TIP: The definition of insured includes successors by operation of law but not transferees by sale of the property. Some successors do not fall within either category, such as distributees from trusts and decedent estates, certain corporate or partnership internal transfers, and conveyances into inter vivos trusts. In such situations, counsel should inquire about the availability of a CLTA 107.9 endorsement. See §§7.92-7.93.

For a discussion of the 2006 ALTA owner's policy's expanded definition of "Insured," see §7.35E.

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§7.30 (2) Land

All of the owner's policies define "land" as that referred to in Schedule A (or separate Schedule C if used by the insurer) and affixed improvements. See Condition 1(f) of the CLTA policy, Condition 1(d) of the 1992 ALTA owner's policies, and Condition 1(g) of the 2006 ALTA owners policies. The definition excludes property or easements beyond the Schedule A description, but such exclusion does not modify any access right insured by the policy.

PRACTICE TIP: The description of the insured land is vital to the buyer. The insured buyer (or buyer's counsel) should verify that the description of the property in the policy accurately describes the property to be purchased. The insured cannot rely on the maps attached to the preliminary report or the policy. See §§5.7, 5.10. A civil engineer may sometimes be needed to review and certify the accuracy of a legal description (*e.g.*, metes and bounds descriptions of large or irregularly shaped parcels). On endorsements for property descriptions, see §§7.94-7.96.

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§7.31 (3) Public Records

Public records are defined as records established under state law for imparting constructive notice at the date of the policy. The CLTA policy insures only defects in the title discoverable from an examination of the public record. *Lick Mill Creek Apartments v Chicago Title Ins. Co.* (1991) 231 CA3d 1654, 1659, 283 CR 231. See also §6.62.

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§7.32 (4) Unmarketability of Title

The CLTA policy and the 1992 ALTA extended and standard coverage owner's policies define unmarketability as "an alleged or apparent matter affecting title to the land, not excluded or excepted from coverage," which entitles a purchaser of the insured estate or interest to be released from a contract obligation requiring delivery of marketable title. The 2006 ALTA policies define "Unmarketable Title" as title affected by an alleged or apparent matter that would allow a prospective purchaser, lessee, or lender to be released from a contract requiring the delivery of marketable title.

NOTE: The reference to lessees and lenders in the 2006 policies' definition of "Unmarketable Title" appears to be an expansion of coverage from the earlier policies.

An owner's inability to make economic use of its land is not a title defect under the policy terms. *Hocking v Title Ins. & Trust Co.* (1951) 37 C2d 644, 652, 234 P2d 625. Nor does the physical condition of the property make title unmarketable. *Lick Mill Creek Apartments v Chicago Title Ins. Co.* (1991) 231 CA3d 1654, 283 CR 231. For further discussion of unmarketability of title, see §§6.24-6.26. For an example of unmarketable title (although the title insurance company was willing to insure over the title issue), see *Nebo, Inc. v Transamerica Title Ins. Co.* (1971) 21 CA3d 222, 98 CR 237. See also §§6.24-6.26, 11.62.

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§7.33 b. Arbitration

The 1992 ALTA and CLTA owner's policies (Condition 13 of the CLTA policy and Condition 14 of the 1992 ALTA extended and standard coverage owner's policies) contain identical arbitration clauses giving the insurer the option to arbitrate claims under $1 million. Claims over that amount may be arbitrated only if the insurer and the insured both agree. Arbitration are to be conducted under the rules of the American Arbitration Association (AAA) for matters involving any (1) controversy or claim between the insurer and insured relating to the policy, (2) service of the insurer in issuing the policy, or (3) breach of a policy provision or obligation. Attorney fees may be awarded in accord with the laws of the jurisdiction.

PRACTICE TIP: Although both the CLTA and 1992 ALTA owner's policy specify arbitration under the rules of the American Arbitration Association, the parties may agree to use a private judge or judicial service.

The 2006 ALTA owner's policy increases the threshold below which either the insured or the insurer can require the other to submit to binding arbitration from $1,000,000 to $2,000,000. In addition, the 2006 owner's policy requires the arbitration to be conducted under the ALTA Title Insurance Arbitration Rules, as opposed to those of the AAA. Further, the 2006 ALTA owner's policy makes clear that, except as provided in ALTA's Title Insurance Arbitration Rules, there can be no joinder or consolidation with claims or controversies of other persons. On arbitration procedures, see chap 14.

Like the creditors' rights exclusion, the policy arbitration provision is not acceptable to many sophisticated buyers (and lenders). These insureds may want to use the older policy form, or obtain an endorsement, to remove the arbitration provision. This endorsement (a CLTA 110.1 endorsement; see §§7.84-7.85) is available at no cost. See also §§6.83, 6.87.

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§7.34 7. Duty to Defend

The CLTA policy and the ALTA standard and extended coverage owner's policies limit the insurer's duty to defend to causes of action that allege a title defect insured against by the policy. See Condition 4(a) of the CLTA and 1992 policies; Condition 5(a) in the 2006 policy. The title policy indemnifies the insured for a title loss covered by the policy, not personal casualty losses. Thus, the title insurer may be responsible to defend a cause of action relating to an easement not excepted from coverage by the policy, but not a cause of action relating to the insured owner's personal conduct, such as a battery on the easement holder. On the duty to defend, see §§6.33, 12.27-12.34.

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§7.35 8. Cost Distinctions

The CLTA policy may be more cost effective than the ALTA extended coverage owner's policy, not only because it does not require a survey but also because it is a joint protection policy, covering both the owner and the lender. If there is an existing recent survey, the additional cost for an ALTA extended coverage owner's policy may be minimal, while the scope of coverage is much broader. For a residential one-to-four unit purchaser, the ALTA residential policy without regional exceptions appears to be the most cost-effective policy. See §§7.46-7.47.

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B. COMPARING 1992 ALTA OWNER'S POLICY AND 2006 ALTA OWNER'S POLICY

§7.35A 1. Expansion of "Covered Risks"

Attorneys who deal with first party property coverages are familiar with "Covered Causes of Loss," such as fire and flood, which are covered under the policy. The 1992 owner's policy has no such name for the affirmative insuring provisions. The 2006 owner's policy denotes them as "Covered Risks."

The principal difference between the 2006 and 1992 owner's policies may be the positive approach to clarifying coverage that is afforded by the new policy form. The 1992 owner's policy contains several exceptions to exclusions. Apparently, ALTA intended that title defects falling within an exception to an exclusion would be covered. However, some courts, applying the rule that an exception to an exclusion cannot create coverage (see, *e.g., Elysian Inv. Group v Stewart Title Guar.* Co. (2002) 105 CA4th 315, 324, 129 CR2d 372), interpreted certain coverages narrowly. The 2006 owner's policy eliminates the exceptions or limitations to the exclusions, and adds former exceptions as "Covered Risks." Further, the title industry has viewed fraud and forgery as covered even though not specifically mentioned in the 1970, 1990, or 1992 owner's policies. The 2006 owner's policy specifies that "fraud" and "forgery" are covered risks. See App L, Covered Risk 2(a)(i).

As a result, the 2006 owner's policy contains ten covered risks, compared to only four in the 1992 owner's policy. The covered risks in the 2006 owner's policy are:

1. Title vested other than as stated in Schedule A (see §6.22);
2. Any defect in or lien or encumbrance on title (see §6.23);
3. Unmarketable title (see §§6.24-6.26);
4. No right of access (see §6.27);
5. Violation or enforcement of police powers laws, ordinances, permits and regulations relating to building and zoning, subdivisions, and environmental protection if notice of violation or intention to enforce is recorded in the public record (see §§6.35-6.38);
6. Enforcement of police powers other than those noted in Covered Risk 5 if notice of enforcement appears in the public records (see §§6.35-6.38);
7. Exercise of eminent domain power if notice of exercise is recorded in the public records (see §6.39);
8. Prior taking by a governmental body that is binding on a bona fide purchaser for value and without notice (see §6.39);
9. Creditors' rights coverage (see §6.48); and
10. Post-policy or "gap" coverage (see §7.35G).

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§7.35B 2. Exclusions

The 2006 owner's policy contains five exclusions, compared to four in the 1992 owner's policy. The 2006 policy exclusions are:

1. Police power laws, ordinances, permits, or regulations relating to building and zoning, subdivisions, and environmental protection or the effect of violation of such laws, ordinances, permits, or regulations (see §§6.35-6.38);
2. Eminent domain (pending or prior) (see §6.39);
3. Bona fide purchaser status (see §§6.40-6.45);
4. Creditors' rights exclusion (see §6.48); and
5. Taxes and special assessments in the "gap" (see §7.35G for discussion of "gap" coverage).

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§7.35C 3. Arbitration

The threshold below which either the insured or the insurer can require the other to submit to binding arbitration has been increased from $1,000,000 in the 1992 policy to $2,000,000 in the 2006 policy. In addition, the 2006 owner's policy states that the arbitration is to be conducted pursuant to the ALTA Title Insurance Arbitration Rules, as opposed to those of the American Arbitration Association (AAA). Further, Condition 14 of the 2006 owner's policy arbitration makes clear that, except as provided in ALTA's Title Insurance Arbitration Rules, there can be no joinder or consolidation with claims or controversies of other persons. On arbitration procedures, see chap 14.

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§7.35D 4. Proof of Loss

The 2006 owner's policy eliminates the requirement that the insured claimant always provide a proof of loss. See §§12.16-12.23. Instead, the insurer must first attempt to determine the loss and, if it is unable to do so, may require the insured claimant to furnish a signed proof of loss. The remedy stated in the 1992 policy for failing to provide a proof of loss, terminating the insured claimant's rights, was removed. See §12.23. However, implicit in the 2006 policy is the right of the insurer to withhold payment under the policy until the insured claimant furnishes a signed proof of loss if requested to do so by the insurer. See App L, Condition 4.

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Source: Real Property/California Title Insurance Practice/7 Owner's Policies and Endorsements/§7.35E 5. Expanded Definition of 'Insured'

§7.35E 5. Expanded Definition of "Insured"

Unlike prior policies, the definition of "Insured" in the 2006 ALTA owner's policy includes the trustee or beneficiary of a trust created by the named insured for estate planning purposes.

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§7.35F 6. Increase Regarding Extent of Liability

Condition 8(b)(i) of the 2006 ALTA owner's policy provides for a 10-percent increase in the amount of insurance if the insurer pursues its rights to defend or prosecute an action to establish title and is unsuccessful. Condition 8(b)(ii) gives the insured the choice of having the loss or damage determined as of either the date the claim was made or the date it is settled and paid. These provisions are new to the 2006 policy. Further, the coinsurance provision found in the 1992 ALTA owner's policy (Condition 7(b)) has been eliminated.

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§7.35G 7. Post-Policy or "Gap" Coverage

Covered Risk 10 of the 2006 owner's policy, post-policy or "gap coverage," applies only to title operations that issue final policies showing the date of the policy as the closing date. It does not apply if the final policy shows the date of the policy as the recording date. This provision is designed to protect the insured against loss arising from defects falling within Covered Risks 1 through 9 that are created, attach, or are recorded in the public records between the date of the policy and the recording date of the instrument that vests title as insured.

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§7.35H 8. Exclusion Regarding Liens for Real Estate Taxes

The 2006 ALTA owner's policy adds Exclusion 5, excluding coverage for any lien for real estate taxes or assessments imposed by governmental authority and created or attaching between the date of the policy and the date of recording of the deed or other instrument of transfer in the public records. This exclusion was added because the 2006 policy provides substantial post policy coverage. See §7.35G regarding "gap" coverage.

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Source: Real Property/California Title Insurance Practice/7 Owner's Policies and Endorsements/§7.35I C. Comparison Chart for Covered Risks in Owner's Policies

§7.35I C. Comparison Chart for Covered Risks in Owner's Policies

For comparison, covered risks under the CLTA policy and the 1992 and 2006 ALTA owner's policies are summarized below:

CLTA Policy	1992 ALTA Owner's Policy	2006 ALTA Owner's Policy
Title vested other than as stated in the policy (see §6.22)	Title vested other than as stated in the policy (see §6.22)	Title vested other than as stated in the policy (see §6.22)
Defects in title or liens or encumbrances on title (see §6.23)	Defects in title or liens or encumbrances on title (see §6.23)	Defects in title or liens or encumbrances on title (see §6.23)
Unmarketability of title (see §§6.24-6.26)	Unmarketability of title (see §§6.24-6.26)	Unmarketability of title (see §§6.24-6.26)
Lack of a right of access to and from the land (see §6.27)	Lack of a right of access to and from the land (see §6.27)	Lack of a right of access to and from the land (see §6.27)
		Enforcement of police power laws, ordinances, permits and regulations relating to building and zoning, subdivisions, and environmental protection if notice of violation or intention to enforce is recorded in the public record (see §6.36)
		Enforcement of police powers other than those noted in Covered Risk 5 if notice of enforcement appears in the public records (see §6.37)
		Pending exercise of eminent domain power if notice of exercise is recorded in the public records (see §6.39)
		Prior taking by a governmental body that is binding on a bona fide purchaser for value and without notice (see §6.39)
		Creditors' rights

coverage (see §6.48)

Post-policy coverage (see §7.35G for discussion of "gap" coverage)

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Source: Real Property/California Title Insurance Practice/7 Owner's Policies and Endorsements/§7.35J D. Comparison Chart for Exclusions in Owner's Policies

§7.35J D. Comparison Chart for Exclusions in Owner's Policies

For comparison, exclusions in the CLTA policy and the 1992 and 2006 ALTA owner's policies are summarized below:

CLTA Policy	1992 ALTA Owner's Policy	2006 ALTA Owner's Policy
1.(a) Any law, ordinance, or governmental regulations (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.	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.	1.(a) Any law, ordinance, permit, or governmental regulation (including those relating to building and zoning) restricting, regulating, prohibiting, or relating to: (i) the occupancy, use, or enjoyment of the Land; (ii) the character, dimensions, or location of any improvement erected on the Land; (iii) the subdivision of land; or (iv) environmental protection, or the effect of any violation of these laws, ordinances, or governmental regulations. This Exclusion 1(a) does not modify or limit the coverage provided under Covered Risk 5.
1.(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	1.(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	1.(b) Any governmental police power. This Exclusion does not modify or limit the coverage provided under Covered Risk 6.

resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.	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 that has occurred prior to Date of Policy which would be binding on the rights of a purchaser for value without knowledge.	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 that has occurred prior to Date of Policy which would be binding on the rights of a purchaser for value without knowledge.	2. Rights of eminent domain. This Exclusion does not modify or limit the coverage provided under Covered Risk 7 or 8.
3. Defects, liens, encumbrances, adverse claims, or other matters: (a) whether or not recorded in the public records at Date of Policy, but 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 insured mortgage or for the	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.	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 (however, this does not modify or limit the coverage provided under Covered Risk 9 and 10); or (e) resulting in loss or damage that would not have been sustained if the Insured Claimant had paid value for the Title.

estate or interest insured by this policy.

4. Unenforceability of the lien of the insured mortgage because of the inability or failure of the insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with the applicable doing business laws of the state in which the land is situated.

5. Invalidity or unenforceability of the lien of the insured mortgage, or claim thereof, which arises out of the transaction evidenced by the insured mortgage and is based upon usury or any consumer credit protection or truth in lending law.

6. Any claim, which arises out of the transaction vesting in the insured the estate or interest insured by this policy or the transaction creating the interest of the insured lender, by reason of the operation of federal bankruptcy, state insolvency or similar creditors' rights laws.

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 when the preferential transfer results from the failure:

(i) to timely record the instrument of transfer; or

4. Any claim, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that the transaction vesting the Title as shown in Schedule A, is

(a) a fraudulent conveyance or fraudulent transfer; or

(b) preferential transfer for any reason not stated in Covered Risk 9 of this policy.

(ii) of such recordation to impart notice to a purchaser for value of a judgment or lien.

5. Any lien on the Title for real estate taxes or assessments imposed by governmental authority and created or attaching between Date of Policy and the date of recording of the deed or other instrument of transfer in the Public Records that vests Title as shown in Schedule A.

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§7.36 III. RESIDENTIAL TITLE INSURANCE POLICIES

The 1987 ALTA residential title insurance policy (ALTA residential policy) was designed for use with one-to-four single family residential lots and condominium units. For a copy of ALTA residential policy, see App M. The ALTA residential policy is also called the "plain language policy" because of its efforts to avoid legalese. See §§7.37-7.49.

In 1997, various title companies began offering an expanded coverage residential policy (or, in some cases, an endorsement to the ALTA residential policy). This expanded policy uses the plain language of the ALTA residential policy and offers all of its coverage, with additional coverage, for an additional fee (typically an extra 10 percent premium). The CLTA issued expanded homeowner's policies in 1998, 2003, and 2008 with even more coverage. See §7.49A-7.49J. Expanded coverage is also available for the lender. See §8.33L.

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A. Anatomy of 1987 ALTA Residential Title Insurance Policy

§7.37 1. Owner's Information Sheet and Table of Contents

The ALTA residential policy begins with an owner's information sheet, which briefly summarizes the policy's features, including the following:

- The policy is a legal contract;
- The policy applies to one-to-four residential lots or condominium units;
- The policy insures risks to land title;
- The policy is limited by exclusions, exceptions, and conditions;
- The policy should be retained even after the land is transferred; and
- No further premiums are due.

The information sheet is followed by a table of contents, which lists the major parts of the policy and briefly states what each part contains.

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§7.38 2. Owner's Coverage Statement

In the 1970s and 1980s some title insurance companies, by attaching CLTA endorsements, such as a CLTA series 126 endorsement, expanded the standard coverage owner's policy issued to homeowners of standard subdivisions. See §§7.65-7.67. The ALTA residential policy incorporates some of the coverage provided by the CLTA series 126 endorsements into the insuring clauses of the policy, titled "covered title risks," eliminating the need for some endorsements.

The owner's coverage provision states that the insured is covered for actual loss "resulting from… any title risks covered by this Policy—up to the Policy Amount and any costs, attorney fees and expenses we have to pay under this Policy."

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§7.39 3. Covered Title Risks

The ALTA residential policy lists the following covered title risks that affect the insured's title on the date of the policy:

- Another's interest in the title;
- A document not properly signed, sealed, acknowledged, or delivered;
- Forgery, fraud, duress, incompetency, incapacity, or impersonation;
- A defective recording of any document;
- Lack of legal right of access to and from the land;
- Restrictive covenants limiting use of the land;
- A lien on title (mortgage, deed of trust, judgment, tax, special assessment, or association charge);
- Prepolicy mechanics' liens not agreed to by the insured;
- Others' rights arising from leases, contracts, or options;
- Another's easement on the land;
- Title is "unmarketable" (defined as allowing another person to refuse to perform a contract to purchase, lease, or mortgage);
- Forced removal of an existing structure (other than a boundary wall or fence) because it encroaches onto adjoining lands or an easement, violates a Schedule B restriction, or violates a zoning law;
- Inability to use the land as a single-family residence because it violates a Schedule B restriction or a zoning law; and
- Other defects, liens, or encumbrances.

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§7.40 4. Duty to Defend

The ALTA residential policy states that the title insurance company will defend the insured's title in a court case based on a covered risk. The title insurance company agrees to pay attorney fees and costs incurred in connection with this defense. The title insurance company can terminate this duty to defend by exercising certain options described in the conditions. See §7.45.

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5. Schedules A and B

§7.41 a. Schedule A

Schedule A provides the following basic identifying data on the policy, the insured, and the insured property:

- Policy number;
- Date of the policy;
- Policy amount;
- Policy premium;
- Name of the insured;
- Interest of insured in the land; and
- Description of the insured land.

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b. Schedule B

§7.42 (1) Typewritten Exceptions

Schedule B lists the typewritten exceptions that relate to the insured property. On typewritten exceptions generally, see §§5.9-5.19, 6.55-6.57.

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§7.43 (2) Regional Exceptions

In California, some title insurance companies add regional exceptions to the ALTA residential policy, which are phrased in plain language. These exceptions cover some or all of the matters in the Western Regional Exceptions (see §§6.5, 6.8, 6.53, 7.11, 7.21) and include off-record items, such as exceptions that would be shown on a survey.

Whether to add the regional exceptions to the ALTA residential policy is an underwriting decision made for each geographic location. A county, a subdivision, or a tract may have certain off-record risks (*e.g.*, boundary discrepancies, lot line problems, or survey issues). Each title insurance company in the area underwrites these issues according to its own title search and claims experiences.

PRACTICE TIP: Rural or mountainous counties and areas that grew haphazardly rather than in conformance with a subdivision map or parcel map, are most likely to add the regional exceptions to the ALTA residential policy. Alternatively, the ALTA residential policy may not be available at all in these areas. Practice varies among title insurance companies; if the ALTA residential policy is not available at all or available only with these regional exceptions from one insurer, counsel should contact other title insurance companies.

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§7.44 6. Exclusions

The ALTA residential policy excludes from coverage losses resulting from the following:

- Governmental police power and the existence or violation of law or governmental regulation unless notice of the violation appears in the public records as of the date of the policy (see also §§6.35-6.38);
- Right to take land by eminent domain unless a notice of exercise of this right appears in the public record on, or the taking occurred before, the date of the policy (see also §6.39);
- Title risks permitted by the insured or known by the insured, but not by the insurer, that do not result in a loss for the insured or that first affect title after the date of the policy (see also §§6.40-6.42);
- Failure to pay value for title (see also §6.45); and
- Lack of ownership of land outside the insured property or in streets, alleys, or waterways touching the land.

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§7.45 7. Conditions

The insurance provided by the ALTA residential policy is further limited by the conditions that cover the following topics:

- Definitions;
- Continuation of coverage;
- How to make a claim (including how to provide notice and proof of loss);
- Insurer's choices after a claim is made (including canceling the policy by paying the policy amount less costs incurred to date for defense);
- Handling a claim or a court case;
- Limitation of the insurer's liability;
- Transfer of the insured's rights on settlement (subrogation);
- Right to demand arbitration; and
- Limitation of insurer's liability to the policy.

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B. Comparing CLTA Standard Policy With 1987 ALTA Residential Policy

1. Advantages of 1987 ALTA Residential Policy

§7.46 a. Expanded Coverage

Counsel for a residential purchaser who cannot afford the ALTA extended coverage policy should consider the ALTA residential policy as an alternative to a standard coverage CLTA policy. It is advantageous for owners of one-to-four residential units because it provides a layperson's wording to coverage, defense, and indemnity obligations in the policy. With or without the regional exceptions (see §7.43), the ALTA residential policy covers matters affecting transactional validity such as fraud, forgery, and lack of delivery.

If a claim is filed, the ALTA residential policy's broad coverage and plain language appears to put a greater burden on the insurer in analyzing the claims coverage, ultimately for an insured's greater benefit. Finally, the ALTA residential policy (without regional exceptions) covers off-record matters that would be disclosed by a physical inspection and that are excluded from coverage in the CLTA owner's policy.

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§7.47 b. Cost

The ALTA residential policy poses higher risks to the insurer than does the CLTA policy because of its extended coverage, even when the ALTA residential policy is issued for a subdivision without known off-record problems. However, most title insurance companies price the ALTA residential policy, with customary regional exceptions, at a rate comparable to a CLTA policy (rather than the more expensive ALTA extended coverage owner's policy). The cost of the ALTA residential policy increases if one or more of the customary regional exceptions are deleted.

PRACTICE TIP: The ALTA residential policy is not always available. Some title insurance companies do not offer this policy at all in some areas. See §7.43.

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§7.48 2. Use of Endorsements

If the insurer will issue the CLTA owner's policy only, counsel should inquire about available endorsements (such as the CLTA series 126 or "homeowner's" endorsements) to ascertain whether coverage can be expanded for a residential lot-and-block buyer. See §§7.65-7.67.

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§7.49 3. Limitation on Coverage

It is important for an insured to understand the limitations of policy coverages for encroachments or other off-record matters. Even the broad wording of the ALTA residential policy does not assure the exact location of improvements. Moreover, the insured may be able to invoke coverage only if there is a "forced removal" of an existing structure (other than a boundary wall or fence). The mere existence of an encroachment does not invoke coverage. *Manneck v Lawyers Title Ins. Corp.* (1994) 28 CA4th 1294, 33 CR2d 771. For further discussion of *Manneck*, see §11.83.

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C. Comparing 1990 CLTA Standard Policy, 1992 ALTA Residential Policy, and CLTA Homeowner's Policies

§7.49A 1. Basic Coverage

The CLTA adopted a broad new form of title policy for homeowners in June 1998, called the Homeowner's Policy of Title Insurance. Updated versions were added in 2003 and 2008. See App O. Although similar to the ALTA residential policy in their use of plain language, these policies provide much additional coverage. They are the best and most complete standard policies available to individuals who own a residence.

The policies add coverage that was previously available only by endorsement as well as coverage that has never been available before. A most unusual feature in the context of title insurance is coverage for certain post-policy matters.

The typical premium is 10 percent above the usual CLTA owner's policy rate. This additional premium buys, among other things, post-policy coverage for forgeries and construction by a third party of structures encroaching onto the insured's land. It also provides continued coverage after a transfer of title to a trustee of a trust in which the insured was the settlor or trustor.

The ALTA has adopted each version of the CLTA homeowner's policy form as the ALTA Homeowner's Policy of Title Insurance.

PRACTICE TIP: Counsel advising homeowners at the time of purchase of an improved one-to-four family residence should advise their clients to seriously consider purchasing the additional coverage available under a CLTA homeowner's policy for the typical additional premium of 10 percent. Counsel retained when a residential owner is having problems should keep in mind that the owner may have obtained enhanced coverage by purchasing the homeowner's policy when acquiring the property. For instance, counsel thinking in terms of traditional title insurance might not think of the coverage for lack of building permits given in the new policy.

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Source: Real Property/California Title Insurance Practice/7 Owner's Policies and Endorsements/§7.49B a. Violation of Subdivision Law

§7.49B a. Violation of Subdivision Law

A violation of a subdivision law or regulation affecting the insured land that exists when a CLTA homeowner's policy is issued is covered if:

- The insured party is unable to obtain a building permit;
- The insured party is forced to correct or remove the violation; or
- Someone else has a legal right under contract to purchase or lease the land but refuses to do so, or a lender refuses to make a mortgage loan because of the violation that existed when the policy was issued.

The policy specifies a maximum limit that can vary by title company, but a $10,000 maximum benefit and a 1-percent or $2500 deductible (whichever is less) is typical.

This coverage is available under the homeowner's policy but not under the CLTA standard coverage policy.

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§7.49C b. Building Permit and Zoning Violations

A CLTA homeowner's policy covers remedial work or the forced removal of an existing structure, other than boundary walls or fences, because the existing structure was built without obtaining a building permit from the proper government office or violates a zoning ordinance.

The original expanded coverage in this area was tied to forced removal, not forced remediation. This expansion of coverage is significant because a homeowner is far more likely to be forced to correct a building permit or zoning violation than to actually remove the structure. The homeowner is covered for losses up to an amount specified in the policy (typically $25,000 after a deductible, usually 1 percent of the policy) for building permit violations and forced remediation of zoning violations and up to the full policy amount for forced removal of structures due to zoning violations.

Remedial coverage is not available under the ALTA residential policy or the CLTA standard coverage policy; coverage for forced removal is available under the homeowner's policy.

This coverage could have been very valuable to the buyer's agent in *Field v Century 21 Klowden-Forness Realty* (1998) 63 CA4th 18, 73 CR2d 784, because the insurance company would have paid for the necessary remedial measures. The buyers sued their agent for, among other things, "failing to investigate the status of permits for room addition."

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Source: Real Property/California Title Insurance Practice/7 Owner's Policies and Endorsements/§7.49D c. Encroachment

§7.49D c. Encroachment

Forced removal of the insured's encroachment onto another parcel, easement, or setback line is covered by the CLTA homeowner's policies. Previous policies excluded boundary walls and fences from this type of coverage. The current policy usually limits the coverage to a maximum of $5000 (after a 1-percent deductible) for boundary wall and fence encroachments. Encroachments by the insured's boundary walls and fences are not covered under CLTA standard coverage and ALTA residential policies. Encroachments onto the insured parcel are insured against if someone refuses to buy, lease, or accept a security interest in the insured land because of the encroachment.

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§7.49E d. Access

The CLTA homeowner's policies expand access coverage to include actual vehicular and pedestrian access to and from the land, based on a legal right. The access coverage traditionally provided by title insurance was tied to a legal right of access and did not include actual access. This is not covered under CLTA standard coverage and ALTA residential policies

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§7.49F e. Restrictive Covenant Violations

Coverage is provided for violations of restrictive covenants occurring before the homeowner acquired the land if the homeowner is forced to correct or remove the violation or if the homeowner's title is lost or taken because of the violation. Examples of such violations would include the following, if not permitted by the applicable restrictions:

- Additional buildings;
- Types of roof material;
- Color of home;
- Number of stories; and
- Types of fencing.

This coverage has been available by endorsement for some time; it was never provided automatically and was rarely requested by homeowners.

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§7.49G f. Automatic Coverage Increases

The CLTA homeowner's policies provide for an automatic increase of 10 percent of the policy amount for each year of the first 5 years up to a maximum of 150 percent. This feature is not available under CLTA standard coverage and ALTA residential policies without an endorsement.

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§7.49H 2. Continuation of Coverage

The ALTA residential policy provides protection while the insured:

- Holds title;
- Holds a mortgage from anyone who buys the insured's land; or
- Is liable for any title warranties.

It also protects anyone who receives title because of the insured's death.

The CLTA homeowner's policies are simpler and broader. They cover the insured forever. They cover anyone who receives title because of the insured's death, including beneficiaries of the insured's trust. They also cover spouses receiving title from the insured as a result of dissolution and cover the trustee of a trust to whom the insured transfers title.

PRACTICE TIP: Occasionally, prior owners in the chain of title are sued in an action for quiet title. Counsel representing a prior owner should tender defense to the title insurer in light of the "forever" coverage. Under the homeowner's policies, estate planning counsel no longer needs to be concerned about obtaining a 107.9 endorsement (additional named insured) to be sure that the trustee of a trust is covered when counsel has a client transfer title to a trustee. Further, the beneficiaries of the trust become covered on the insured's death. This allows the property to be distributed from the trust without terminating title coverage. This coverage recognizes the growing popularity of living trusts.

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§7.49I 3. Post-Policy Event Coverage

Several important new risks are now covered on a post-policy basis. This means that some defects in title that did not exist at the time the insured purchased the property but are now asserted by others are covered up to the policy limits.

These post-policy covered risks involve situations in which someone other than the homeowner claims:

- To own an interest in the title;
- To have rights affecting the title arising out of leases, contracts, or options;
- To have rights affecting the title arising out of forgery or impersonation;
- To have an easement on the land, or have a right to limit the insured's use of the land; or
- That the title is defective.

The following are examples of this post-policy protection:

EXAMPLE 1: Post-Policy Forgery. The homeowner is covered when someone forges the insured's signature to a deed or mortgage in an effort to sell or impose a lien or restriction on the home.

EXAMPLE 2: Post-Policy Encroachment. This coverage protects the homeowner if, after the purchase, someone else builds a structure (excluding boundary walls and fences) that encroaches on the homeowner's land.

EXAMPLE 3: Post-Policy Cloud on Title. Coverage is provided when the homeowner's title is clouded because someone recorded in the land records a document containing the legal description of the homeowner's land, whether by mistake or in a specific effort to cause the insured harm, and the homeowner is prevented from completing a loan or sale transaction on their home.

EXAMPLE 4: Post-Policy Adverse Possession. Coverage is extended to a homeowner when someone claims to have the insured's title arising out of some continued use and occupancy.

EXAMPLE 5: Post-Policy Easement by Prescription. The homeowner is covered if another party claims to have the right to use a part of the insured's land as an easement because of continuous use over time.

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§7.49J 4. Restrictions on Policy

The CLTA homeowner's policies are likely to be issued by title companies only in the absence of high-risk situations, such as older subdivisions, or land described by metes and bounds or sectional descriptions.

Two specific restrictive requirements for issuing a CLTA homeowner's policy are not applicable to issuing an ALTA residential policy. The land must be an *improved* residential lot on which a one-to-four family residence is located. The ALTA residential only requires that the land be a one-to-four family residential lot; the lot does not have to be improved with a one-to-four family residence. Also, only natural persons can be insured by the homeowner's policy. The term is defined in Condition 1(e) as:

> e. Natural Person—a human being not a commercial or legal organization or entity. Natural person includes a trustee of a Trust even if the trustee is not a human being.

In connection with this expanded coverage, a paragraph has been added to the exclusions to provide that the policy does not provide coverage for loss resulting from:

> 2. The failure of Your existing structures, or any part of them, to be constructed in accordance with applicable building codes. This Exclusion does not apply to violations of building codes if notice of the violation appears in the public records at the Policy Date. (1998 and 2003 versions).
> 2. The failure of Your existing structures, or any part of them, to be constructed in accordance with applicable building codes. This Exclusion does not limit the coverage described in Covered Risk 14 or 15. (2008 version).

Even this exclusion, however, gives broader coverage than traditional title insurance. A standard policy would not cover even a recorded notice because it is not a defect, lien, or encumbrance on *title,* but rather, affects the physical improvements located on the land. *Glavinich v Commonwealth Land Title Ins. Co.* (1984) 163 CA3d 263, 209 CR 266.

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IV. COVERAGE FOR OPTIONEES, VENDEES, TENANTS, AND OTHER OWNERS

A. Insuring Optionee

§7.50 1. Insurable Interest

Before a title insurance policy can be obtained, the proposed insured must hold some interest in the property. This requirement raises the question of whether an optionee has an insurable real property interest. A few jurisdictions hold that an optionee does not have a real property interest (see, *e.g., Shaughnessy v Eidsmo* (Minn 1946) 23 NW2d 362) and that an option is a mere contract right. Other jurisdictions, including California, hold that the optionee has a protectable and recordable real property interest, even though the optionee has not acquired title. See 1, 5 Miller & Starr, California Real Estate §§2:7-2:10, 11:100-11:109 (3d ed 2000). See also *Claremont Terrace Homeowners' Ass'n v U.S.* (1983) 146 CA3d 398, 194 CR 216.

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§7.51 2. Desire for Coverage

Practical concerns created the demand for optionee coverage. Before expending consideration for an option to purchase property, an optionee may want insurance that the optionor holds vested title to the property. (Relying on a preliminary report alone would be misplaced; see §§7.3, 5.1, 5.4.) If, at the time the parties enter into an option contract, the optionor is not vested in title, the optionee may not have a cause of action, based on this fact alone. Under the reasoning of *Luette v Bank of Italy* (9th Cir 1930) 42 F2d 9, a default in performance would not occur until performance is actually required under the option. A title policy insuring the optionee as of the date of the recorded memorandum of option assures the insured that the optionor holds vested title.

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§7.52 3. Method of Insuring

To meet the optionee's desire for coverage, some title insurance companies insure the priority of the option right and the optionee's right to enforce the option. This objective is achieved by an endorsement that may exclude from coverage matters such as the following:

- Failure of the insured to comply with the option contract;
- Foreclosure of prior liens;
- Mechanics' liens;
- Bankruptcy attacks on the option;
- Eminent domain awards;
- Failure to secure proper conveyancing documents on exercise of the option; and
- Attorney fees resulting from actions brought to ascertain who is entitled to receive option payments.

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§7.53 4. Underwriting Criteria

Before providing coverage, the insurer requires recordation of a memorandum of option to establish the optionee's rights in the public records. The recorded memorandum may be necessary to establish priority for the parties (*e.g.*, if there is a postpolicy conveyance by the optionor or a lien against the optionor). The date of the policy will be the date the memorandum is recorded. Matters arising after that date will be excluded from coverage. As an underwriting decision, the insurer may also exclude the option contract from coverage to make it clear that the title insurance company is not insuring the parties' actual performance of the contract.

PRACTICE TIP: Counsel should consider obtaining a new policy for the optionee on transfer, insuring the conveyance of title from the optionor. Many title insurance companies offer substantial discounts in converting the optionee policy to a fee owner's policy. A binder can also be used to reduce costs in such cases. See §§3.20-3.22.

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§7.54 B. Contract of Sale Vendee

California courts have recognized that a contract vendee has an equity ownership in real property and may be treated as an owner despite the retention of legal title in the vendor's name. *Roemer v Pappas* (1988) 203 CA3d 201, 205, 249 CR 743. Some title insurance companies insure the interest of a contract vendee created under a recorded contract of sale (or memorandum). The policy insures the contract vendee of the vesting of the fee title owner, and of the relative priority of covenants, easements, liens, and encumbrances existing as of the date of the policy. To avoid any inference that the policy insures the performance of the contract of sale, some underwriters require that the contract be shown as an exception.

PRACTICE TIP: Many title insurance companies offer substantial discounts in converting a vendee's policy to a fee owner's policy.

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§7.55 C. Leaseholds

ALTA formerly offered a special leasehold policy form to insure the vestee of a leasehold estate under a lease, a sale-leaseback, or a fee-leasehold severance transaction, but it was discontinued in 2001. See §6.14. Currently, the ALTA extended coverage owner's policy with a leasehold endorsement (ALTA Endorsement 13-06) is commonly used in California to insure leasehold estates.

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§7.56 1. Underwriting Criteria

Most insurers review the lease in order to:

- Confirm the existence of the lease and that it is facially valid;
- Confirm the accuracy of the terms of the memorandum of lease (*e.g.,* identity of the parties and the term);
- Ascertain whether the lease contains any unusual provisions that might affect coverage (*e.g.,* third party rights); and
- Garner the information necessary to complete Schedule A (*e.g.*, the term).

Because recordation provides constructive notice of the leasehold estate, before providing coverage all title insurance companies require either the recording of the lease or, more likely, the memorandum of lease.

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§7.57 2. Calculating Amount of Loss

ALTA's 13-06 endorsement provides that, if the insured is evicted for a reason covered under the title policy, computation of loss will include the following items:

> the value for the Remaining Lease Term of the Leasehold Estate and any Tenant Leasehold Improvements existing on the date of the Eviction. The Insured Claimant shall have the right to have the Leasehold Estate and the Tenant Leasehold Improvements valued either as a whole or separately. In either event, this determination of value shall take into account rent no longer required to be paid for the Remaining Lease Term.

Additional items of loss are also listed in the endorsement.

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§7.58 D. Mineral Rights

The old ALTA oil leasehold policy was used so rarely that it was withdrawn. Coverage is now provided under an ALTA owner's policy or loan policy, with a mineral rights endorsement. See §§7.90-7.91. Neither policy excludes the ownership of mineral rights (including gas and oil rights) from coverage unless the grant, reservation, or exception of rights appears in the chain of title. If so, this will appear either as an exception to the insured description or as an exception to title in Schedule B of the policy. Common title insurance practice is to reflect the presence or absence of attendant surface entry rights only if expressly referred to in documentation, and not if they are implied.

The absence of the right to exploit minerals is often of little concern to a landowner. Concern, and insurance coverage, is rather focused on the effect of the exercise of surface entry rights on surface improvements as reflected in a CLTA mineral rights endorsement to the ALTA owner's or lender's policy.

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§7.59 1. Scope of Coverage

A typical mineral rights endorsement includes protection against damage to existing improvements resulting from exercise or use of a surface right for extraction or development of reserved mineral rights. See CLTA Endorsement 100.29. If the surface rights were either expressly waived at the time the minerals were reserved or subsequently released, an endorsement may be issued. If rights of surface entry have not been waived, issuance of the endorsement may be considered depending on specific facts, including the nature and value of the mineral interest, local geology, local zoning restrictions of mining activity, and existing improvements on the property. In either case, the title insurer will likely examine any underlying documentation purporting to effect the right of surface entry.

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§7.60 2. Exceptions From Coverage

The mineral rights endorsement, when combined with an extended coverage policy, will insure certain "off-record" matters, including those shown on surveys, encroachments, or other nonrecord matters. See §7.24.

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§7.61 3. Calculating Amount of Loss

Unlike the ALTA leasehold endorsement, the mineral rights endorsement does not provide a formula for calculating a compensable loss and appears to limit loss payment to actual loss up to the amount of the policy, covering against "loss which the insured shall sustain by reason of damage."

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E. 1991 ALTA United States Policy

§7.62 1. Scope of Coverage

When the United States government or a United States government agency acquires title to real property, it may obtain the ALTA United States policy, which insures against:

- Title being vested other than as stated in Schedule A;
- Any defect, lien, or encumbrance on the title;
- Unmarketability of title;
- Lack of a right of access; and
- When the insured acquires title by condemnation, failure of the commitment for title insurance, as of the date of a filed lis pendens notice or declaration of a taking, to disclose the identity of parties with an interest in the land as shown in the public records.

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§7.63 2. Exclusions

In addition to the standard coverage exclusions, this policy does not insure against invalidity or insufficiency of any condemnation proceeding, except as set forth in insuring provision 5 (exclusion 4). In condemnation proceedings, the title insurance company insures only the status of the title, not the underlying performance. However, certain record title matters are covered in the insuring clauses if the prior commitment for title insurance fails to properly disclose all parties with an interest in the record title (see final bulleted item in §7.62), which demonstrates that much of the record title examination relied on by the insured comes from the commitment or litigation guaranty.

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§7.64 V. COMMON OWNER ENDORSEMENTS

An endorsement modifies the coverage terms of the policy. Most endorsements are offered on lender's policies (see discussion in chap 8). Some endorsements, drafted for an ALTA lender's policy, can be modified and issued in conjunction with an owner's policy. For example, while the CLTA 100 endorsement (insuring certain matters relating to restrictions, easements, and minerals) is designed for lenders, some companies issue modified versions on an owner's policy with underwriting approval.

Effective January 1, 1997, the CLTA modified virtually all its numbered endorsements that use the word "assurance." That word has been deleted and replaced with "insurance." The CLTA's purpose in making this change is to clarify that these endorsements are intended to provide only additional insurance. By issuing assurances, title insurance companies did not intend to assume any liability beyond indemnity coverage.

Commonly offered endorsements are numbered and published by the CLTA or the ALTA. In California, the CLTA endorsements are used most often with both CLTA and ALTA policies. For a list of CLTA endorsements, see App N. The ALTA endorsements are usually requested in a closing involving out-of-state counsel. See §§7.99, 8.102. Each title insurance company has its own set of frequently requested endorsements, which it has named or numbered. If none of these endorsements meets the owner's needs in a particular transaction, counsel should negotiate a special endorsement with the title insurance company to provide the desired coverage.

PRACTICE TIP: If a given title insurance company is unwilling to provide the coverage, counsel should contact other title insurance companies to see whether the coverage is available elsewhere.

An important factor to evaluate when analyzing which endorsements are needed is the cost of the endorsement. Some are free, and others cost as much as 25 percent of the premium. Competition among title insurance companies keeps the costs for each endorsement fairly comparable.

NOTE: Some title insurance companies offer a CD-ROM containing the standard form title policies, the CLTA and ALTA endorsements, and the company's numbered endorsements. Some also contain underwriting guidelines.

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A. CLTA Residential Property Endorsements

§7.65 1. Homeowner's Endorsements

For decades, many purchasers of one-to-four residential units found additional coverage automatically attached to their standard CLTA owner's policy under a CLTA 126.1 homeowner's endorsement. This endorsement insures a residential structure used as the owner's principal residence. It does not insure perimeter fences, walls, or plantings. It covers matters similar to the covered title risks of the ALTA residential policy and is intended to be used only with the CLTA owner's policy. See §7.39 on ALTA residential policy's covered title risks.

NOTE: The ALTA residential policy covers forced removal of an existing structure because of a violation of existing zoning law or inability to use the land as a single-family residence because the use violates an existing zoning law. See §7.39. The CLTA 126.1 endorsement also provides coverage against a final court order requiring removal of a residential structure based on violation of zoning regulations governing area, width, depth of building site, floor space, set-back, or height of the residence. See §§7.66-7.67.

The CLTA 126.1 endorsement is still available, but not in all areas. See §7.67.

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§7.66 a. CLTA 126.1, 126.2, and 126.3 Endorsements

The CLTA 126.1, 126.2, and 126.3 endorsements insure against losses from the following matters:

- Prepolicy mechanics' liens for labor or materials not agreed to by the insured;
- A forced removal of the residential structure or interference with the use of the insured property for residential purposes because of encroachments, violations of certain covenants, conditions or restrictions (CC&Rs), or zoning ordinances; and
- Damage to the residence from the surface extraction of minerals excepted from the legal description or as shown in Schedule B.

Some companies issue a modified form, the CLTA 126.2 endorsement, tailored for condominium purchasers, which insures that the condominium was validly created and that its appurtenances, easements, and common areas are a part of the defined residential structure. The CLTA 126.3 endorsement, providing the same coverage as a CLTA 126.1 endorsement, may be used for single-family residences or large apartment complexes.

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§7.67 b. Underwriting Criteria

The availability of the CLTA 126.1 endorsement depends on the location of the property, the method used to describe the property, and the historic underwriting analysis by the local office issuing the endorsement. In certain geographic areas, the endorsement might be automatically issued with every CLTA policy for a residential insured. In areas known to have off-record title risks that the title insurance company is unwilling to insure (*e.g.*, rural or mountainous areas or nonstandard subdivisions), the company may not issue the CLTA 126.1 endorsement. The decision to issue this endorsement may be made on a county, subdivision, tract, or case-by-case basis. If this endorsement is requested in a problem area, the insurer may require a physical inspection and then exclude from the endorsement any problem discovered in the inspection.

PRACTICE TIP: Practice varies between title insurance companies; if one insurer will not provide the CLTA 126.1 endorsement, counsel should contact other insurers to ascertain its availability.

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2. Inflation Protection

§7.68 a. Endorsement

For a time in the inflationary 1970s, title insurance companies issued an inflation protection endorsement to increase residential owners' policy amounts based on the consumer price index. With the stabilization of the residential economy, some companies abandoned these endorsements in the belief that an inflationary index is not an adequate measure of property values. Some title insurance companies do not issue this endorsement for commercial property.

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§7.69 b. Underwriting Criteria

Historically, the inflation protection endorsements have been issued without an underwriting basis. An endorsement is usually available on request at little or no cost for residential properties.

PRACTICE TIP: Issuance of this endorsement often leads to consideration of reinsurance by the insured and the insurer because the face amount of the policy at its issuance does not represent the actual liability under the policy. Liability will increase over time. On reinsurance generally, see §§3.8-3.10.

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§7.70 3. Use of Commercial Endorsements for Residential Property

Various commercial endorsements discussed in §§7.71-7.98 are available to residential owners in certain instances. They may be costly or available only with an ALTA owner's policy, thus requiring an ALTA survey. On ALTA surveys generally, see §§4.30-4.34.

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§7.71 B. CLTA Commercial and Subdivision Endorsements

Although the CLTA differentiates between owners and lenders in creating its endorsements, in practice certain endorsements are used mainly by commercial rather than residential insureds because the endorsements:

- Are too costly for residential owners; or
- Were specifically designed for commercial properties.

Some endorsements are specifically designed to protect residential subdivision development and, because they are designed to meet the needs of developers (not individual homeowners), are also discussed in §§7.72-7.98 on commercial endorsements.

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1. Access

§7.72 a. CLTA 103.4 and 103.7 Endorsements

Most commercial owners want insurance that the land is accessible to a physically open street, particularly if access is a paramount concern to the operation of the business (*e.g.*, shopping centers, fast-food chains). When an easement is across an adjacent property, the CLTA 103.4 endorsement insures that the owner will have access through the described easement to a specified public street. The CLTA 103.7 endorsement insures the owner that the land abuts a specifically named street, but it does not insure access to that street. To obtain this coverage and make certain there are no gaps in the access to the property, the CLTA 103.7 endorsement should be modified to provide that the insured property both abuts *and has access to* the named street. These endorsements are also available to tenants under a leasehold owner's policy.

EXAMPLE: Assume that a buyer acquires property to build a shopping center. The buyer wants insurance covering access to one or more primary streets. The mere insurance against "lack of a right of access" on the face page of the CLTA and ALTA owner's policies will be inadequate if access proves to be through a back alley only.

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§7.73 b. Underwriting Criteria

In addition to a review of the record title, such as deeds of easement, the insurer may require a survey and an inspection before issuing either a CLTA 103.4 or 103.7 endorsement. The insurer will confirm that the property abuts a street, and not a private easement, before it issues a CLTA 103.7 endorsement.

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2. Allocating Policy Liability

§7.74 a. CLTA 107.1 Endorsement

The CLTA 107.1 endorsement allocates the insurer's liability under the policy between or among the lots insured by the policy. This endorsement is used if the purchaser of two or more lots wants a precise allocation of liability. Allocation may benefit the insured by placing a known value on a specific lot if a claim arises on that lot.

Without this endorsement, the ALTA extended and standard coverage owner's policies provide (Condition 8) that, if two or more parcels are not used as a single site, a loss on one site will be settled on a prorata basis. This prorata assessment of loss is made as of the date of the policy unless the insurer has agreed otherwise by endorsement.

EXAMPLE: Assume that the insured acquires two lots; one is vacant and the other is improved with an established hotel. The two lots are insured in one ALTA owner's policy for $20 million. A title claim then arises on the hotel, creating a loss of $18 million. Without an allocation endorsement, the loss would be paid on a prorata basis and the insured would recover only $10 million. With the endorsement, the loss would be paid according to the amount of liability allocated to the hotel parcel.

An allocation endorsement is not always favorable to an owner. An owner who acquires two or more lots for one integrated purpose usually does not want an allocation.

EXAMPLE: If a buyer acquires three contiguous lots for use as a shopping center, a loss on one lot may affect the entire shopping center and not be limited to the value allocated to that lot. In that situation, the buyer should have the insurer modify or eliminate the allocation provision of the ALTA owner's policy.

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§7.75 b. Underwriting Criteria

Underwriting approval of the allocation endorsement usually requires that the allocation be based on some quantifiable measure, such as tax records, contract prices, acreage, appraisals, or other objective documentary evidence of value. There is no cost for this endorsement.

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3. Coinsurance

§7.76 a. CLTA 114, 114.1, and 114.2 Endorsements

The owner or developer of a substantial commercial project often finds that the title insurance company has its own internal guidelines for the amount of policy coverage it will accept as an insurer. See §3.8. The title insurance company may enter into a coinsurance agreement or a reinsurance agreement with another title insurance company to cover the balance over its own internal limits. For discussion of reinsurance, which is more commonly used than coinsurance and does not require endorsements, see §§3.8-3.10.

If the commercial owner believes that it is in its best interest to allocate coverage amounts between two or more title insurance companies (or if the lender requires it), the owner may obtain an endorsement to provide for coinsurance between two or more companies that establishes an order of liability (*e.g.*, equal or joint and several liability) between the coinsurers. See §§3.11-3.14.

PRACTICE TIP: Many lenders have internal guidelines that dictate how much coverage an insurer can assume. Prospective owners, however, do not frequently analyze the insurer's financial condition. On ascertaining financial condition of insurers, see §3.7. This issue is particularly important in costly commercial projects. For example, the developer of a downtown high-rise hotel should not assume that the proposed insurer can handle coverage of a $50 million policy. Counsel should discuss this matter with the client for consideration in light of development plans and possible analysis of a insurer's financial strength. Reinsurance should be considered. See §§3.8-3.10.

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§7.77 b. Underwriting Criteria

Each coinsurer will conduct its own title search, issue its own preliminary report, and review all closing documents. Each coinsurer will receive a premium for the portion of the liability it is insuring.

PRACTICE TIP: A major owners' objection to coinsurance is that, if a claim does arise, the insured must deal with two policy claims simultaneously. On filing claims, see chap 12.

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4. Contiguity

§7.78 a. CLTA 116.4 Endorsement

The CLTA 116.4 endorsement is available to an owner who is purchasing a neighboring lot or to an owner who is buying two separate but adjoining lots.

If a new lot is located between the previously owned lot and the insured lot, the buyer may want to obtain a CLTA 116.4 endorsement in conjunction with an access or abutment endorsement. See §§7.72-7.73. This endorsement may also be modified to provide coverage against loss resulting from a gap, strip, or gore between the two lots.

EXAMPLE: A contiguity endorsement may be required if two contiguous lots owned in common have survey descriptions starting from different points of beginning, which might create minor gaps in the title. If a third party holds record title to the gaps, construction of one building over the two lots could be prevented.

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§7.79 b. Underwriting Criteria

The insurer will require a title search of the insured parcels, will review all legal descriptions used in the chain of title, and may ask for a survey. If both parcels covered by this endorsement are insured, this endorsement is inexpensive. If one parcel is uninsured, the endorsement is more expensive.

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§7.80 5. Covenants, Conditions, and Restrictions (100 Series)

Many CLTA series 100 endorsements are available to both lenders and owners for both standard and extended coverage policies. Owners will generally find that the cost of those endorsements that are available for both types of policies is greater for a standard coverage policy than for an extended coverage policy. See App N for a list of the CLTA series 100 endorsements and the policies for which they are available.

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§7.81 a. Modified CLTA Endorsement 100

The CLTA 100 endorsement is designed primarily for lender's policies, but many title insurance companies issue modified forms of these endorsements for an ALTA extended coverage owner's policy. The extent of the coverage will vary among title companies. The standard modified form preferred by many title companies offers more limited coverage to owners than that provided to lenders (see §8.52). It insures against losses sustained by reason of the existence of any of the following:

- CC&Rs containing express provisions for forfeiture or reversion of title;
- Present violations of any enforceable CC&Rs;
- Encroachments of existing improvements on adjoining lands (except as shown on Schedule B); and
- Rights to surface extraction or development of the minerals excepted from a description or shown in a Schedule B mineral reservation.

PRACTICE TIP: Counsel should be aware that the coverage of this endorsement is negotiable and some title companies will provide an owner with a modified CLTA 100 endorsement with coverage comparable to that provided a lender (see §8.52), with references to the deed of trust deleted.

PRACTICE TIP: A party who intends to construct improvements should consider requesting the title company to modify the CLTA 100 endorsement to include damage to existing *and future* improvements caused by the exercise of easement and mineral rights. Without this additional language, only existing improvements will be covered.

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§7.82 b. Additional CLTA Series 100 Endorsements

The CLTA 100.5 endorsement protects against losses sustained from a final judgment enforcing CC&Rs based on a prepolicy violation. The CLTA 100.5 endorsement is available for both standard and extended coverage owner's policies, but the cost for the standard coverage policy will be greater.

Subsequently numbered endorsements provide coverage variations, available to both extended and standard coverage polices, including:

- Protection against present or future violations (CLTA 100.6 endorsement);
- Protection against violation of a specific provision of the CC&Rs (CLTA 100.7 and 100.8 endorsements);
- Insurance that CC&Rs do not contain an enforceable reverter, right of reentry, or right of power of termination (CLTA 100.12 endorsement); and
- Insurance that CC&Rs have been properly modified (CLTA 100.17 endorsement).

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Source: Real Property/California Title Insurance Practice/7 Owner's Policies and Endorsements/§7.83 c. Underwriting Criteria

§7.83 c. Underwriting Criteria

Most underwriting decisions are based on some or all of the following criteria:

- Matters disclosed by a survey of the property;
- Matters disclosed by a physical inspection of the property;
- The age of the subdivision in which the property is located;
- The existence of prior insurance on the property; and
- Other inquiries into facts relevant to the requested endorsement.

EXAMPLE: The insurer might inquire into the nature of the CC&Rs to ascertain whether they contain a savings clause that would prevent a forfeiture or reversion by one acting in good faith.

Unless violations of the CC&Rs are found, these endorsements are not difficult to obtain.

PRACTICE TIP: An owner may find that a title company that is reluctant to provide the modified CLTA 100 endorsement will agree to do so if provided with specific site plans.

For further discussion of the CLTA series 100 endorsements, see §§8.71-8.72.

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6. Eliminating Exceptions

§7.84 a. CLTA 110.1 Endorsement

The CLTA 110.1 endorsement is most often used to expand coverage by deleting either a preprinted exception or a Schedule B exception that no longer burdens the property. It is also used after issuance of a policy to delete a typewritten exception that has been released of record.

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§7.85 b. Underwriting Criteria

The underwriting criteria for issuance of this endorsement depends on which exclusion or exception is being deleted from the policy. The insurer might require an indemnity if the matter is subject to the control of the borrower or the seller in the transaction. Alternatively, the insurer may look to documents in the chain of title or off-record information pertaining to that matter that is to be insured over. If this endorsement is used to issue partial extended coverage to an owner, the insurer will follow the procedures used to underwrite the item for an extended coverage policy.

EXAMPLE: If the CLTA 110.1 endorsement is used to delete the exception for matters disclosed by survey (insuring clause 4 of the CLTA policy), then the insured must provide a survey satisfactory to the title insurance company and matters disclosed on the survey will be added as typewritten exceptions to Schedule B of the policy.

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7. Increasing Coverage Amount

§7.86 a. CLTA 107.2 Endorsement

The CLTA 107.2 endorsement addresses the concern that, because the face amount of the title insurance does not change over time, the amount of coverage may not include the cost of improvements or other changes to the property. This endorsement does not date down the title policy, but does increase the face amount of the policy as of the original date of the policy.

EXAMPLE: After construction, an owner will want to increase the amount of the policy because the liability amount that was established when the unimproved land was bought is now inadequate.

This endorsement is particularly important in light of the coinsurance provision of current form policies. See §6.75. Under this provision, if the stated amount of the policy is less than 80 percent of the property's value at the date of the policy, or if improvements are constructed after the date of the policy that increase its value by 20 percent or more, the title company pays only a pro rata share of the loss based on the amount of insurance compared to the value of the property (instead of the full amount of the loss up to the policy limit). The CLTA 107.2 endorsement increases the coverage of the policy to an amount equal to the improved value of the property, but does not date down the policy.

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§7.87 b. Underwriting Criteria

The underwriter will require the insured to explain the purpose for the increased policy amount, will review the last title search, and will confirm that there are no known claims affecting the property. The underwriter may request an affidavit that the insured knows of no defects, liens, encumbrances, or claims insured against by the policy that might result in a loss to the insured under the endorsement. If a claim does exist, the insurer may still increase the coverage amount but will exclude coverage for the existing claim. The charge for this endorsement is the premium amount for the increased rate.

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8. Mechanics' Liens

§7.88 a. CLTA 101.1, 101.4, 101.9, and 101.12 Endorsements

It is rare for a title insurance company to protect an owner against mechanics' liens that arise through that owner's own work of improvement. If the lender demands mechanics' lien insurance, the owner must usually give the title insurance company some measure of protection to induce the company to insure the lender.

CAVEAT: An insurer may provide mechanics' lien coverage to a buyer who acquires the property before expiration of the lien period if the seller can offer proof of payment for all labor and material furnished or proof that adequate funds are available and controlled for the purpose of making payments.

The CLTA 101.1 endorsement insures the owner against loss sustained through a mechanics' lien arising from the work of improvement referred to in a specified notice of completion. (The CLTA 101.9 endorsement does the same and is used if the notice of completion describes only a portion of the land described in the policy.)

The CLTA 101.4 endorsement insures against mechanics' liens that arise from any work of improvement under construction or completed when no notice of completion has been recorded. (The CLTA 101.12 endorsement does the same and is used if applicable to only a portion of the land described in the policy.)

NOTE: Insurers refuse to provide mechanics' liens protection to a lessor when the lessee intends to make substantial improvements under a lease provision. In this circumstance, the probable ineffectiveness of a lessor's notice of nonresponsibility makes the owner-lessor's situation substantially like that of an owner-builder to whom such insurance would not be provided. *English v Olympic Auditorium, Inc.* (1933) 217 C 631, 20 P2d 946; *Benson Elec. Co. v Hale Bros. Assocs. Inc.* (1966) 246 CA2d 686, 55 CR 73. See also *Baker v Hubbard* (1980) 101 CA3d 226, 235, 161 CR 551, in which the court recognized the rule that a landlord's notice of nonresponsibility is ineffective when the lease calls for the tenant to construct the improvements, but held the rule inapplicable on the facts of that case.

On mechanics' lien endorsements generally, see §§8.83-8.84.

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Source: Real Property/California Title Insurance Practice/7 Owner's Policies and Endorsements/§7.89 b. Underwriting Criteria

§7.89 b. Underwriting Criteria

Before issuing a CLTA 101.1 or 101.4 endorsement, title insurance companies usually:

- Require a recorded valid notice of completion;
- Ascertain whether statutory time limits have passed for the filing of claims;
- Ascertain whether any claims have been filed; and
- Undertake some measure of inquiry as to the status of the project (*e.g.*, whether the general contractor signed any waiver or whether any work was done after the notice of completion was recorded).

The title insurance company may also require both an inspection and an indemnity.

NOTE: One of the toughest problems facing title insurers is deciding when a project has commenced for lien priority purposes. Physical inspection of the property just before recordation of the construction loan deed of trust will usually suffice, but it is sometimes extremely difficult to detect minor preliminary work done or materials delivered on some remote portion of a large parcel of property. Moreover, what appears to the inspector to be site improvement work done under a separate contract (which would not constitute commencement of the structural phase of the project (see CC §3135)) will often later be alleged to constitute preliminary work on the construction phase of the project. In trial level decisions, successful arguments have been made that symbolic starts done purely for publicity purposes and not actually necessary for the project are commencements for lien purposes. For an example of how CC §3135 makes the priority provided by CC §3134 inapplicable to site improvements performed under separate contracts, see *Lambert Steel Co. v Heller Fin., Inc.* (1993) 16 CA4th 1034, 20 CR2d 453.

In addition, the insurer will issue the CLTA 101.9 and 101.12 endorsements only by limiting the liability under the endorsement to a specified sum. Both generally require an indemnity from the insured.

PRACTICE TIP: If the title insurance company ascertains that there is a risk of mechanics' liens being filed (*e.g.*, work continued after the notice of completion was recorded), it will take additional time for the company to issue the endorsement (until the statutory time for filing a lien on the new work has run). Alternatively, the title insurance company may require detailed financial information from a proposed indemnitor. In some cases, personal guaranties may be required from shareholders of a corporate indemnitor.

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9. Mineral Rights and Surface Entry

§7.90 a. CLTA 100(3(b)), 100.29, and 110.3 Endorsements

Title insurance companies can issue various endorsements to insure owners against losses related to mineral interests, including the following:

- The CLTA 100 endorsement, Condition 3(b) of the ALTA policy (or paragraph 4 of the modified owner's CLTA 100 endorsement) insures against damages to existing improvements resulting from the exercise of surface rights for extraction or development of minerals.
- The CLTA 100.29 endorsement insures against losses sustained from damage to existing improvements resulting from any surface entry rights for extraction of minerals excepted from the property description or shown as a reservation in Schedule B.
- The CLTA 110.3 endorsement insures the owner that certain mineral rights were released to the surface owner.

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§7.91 b. Underwriting Criteria

The issuance of a mineral rights endorsement may require a mineral estate search and identification of the instrument relied on of record. For a CLTA 100.29 endorsement, the insurer may review a geologic history of the area and the degree of mineral activity there to discuss whether the rights of surface entry have been waived or released. The insurer may review zoning to learn whether a local government bans mineral extraction on the insured property and in the surrounding area.

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10. Name of Insured

§7.92 a. CLTA 107.9 and 107.10 Endorsements

If an entity changes its name, or if there is a change in the method of holding title but not in the ownership interests, the owner should consider requesting the insurer to add the new entity to the existing policy. The CLTA 107.9 endorsement amends the policy to add as a named insured a person or an entity that is a nominal successor in interest to the name insured. The CLTA 107.10 endorsement amends the policy to add as a named insured a party who, erroneously or inadvertently, was not named as an insured when the policy was issued.

These endorsements do not date down the policy nor do they impose liability on the insurer if the added insured fails to acquire an insurable estate or if a lien, defect, or encumbrance attaches to the property because of the new insured's acquisition of an interest in the property. These endorsements are not available to anyone who has purchased an interest in the property.

EXAMPLES: If a limited partnership converts to a general partnership and the ownership interests do not change, the CLTA 107.9 endorsement adds the general partnership as the named insured. If new partners were added at the time of conversion, this endorsement will not suffice. Rather, to protect the new partners, a reissued policy is needed. The CLTA 107.9 endorsement is also used when a married couple conveys property to an inter vivos trust.

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§7.93 b. Underwriting Criteria

For a CLTA 107.9 endorsement, the insurer will need to know the status and relationship of all parties in order to confirm that the transfer is only a nominal transfer, not a sale. For a CLTA 107.10 endorsement, the insurer will confirm that the failure to name the insured in the original policy was because of error, inadvertence, or a misunderstanding.

PRACTICE TIP: The CLTA 107.10 endorsement is also used when a nominee acquires several parcels on behalf of a principal who intends to take title when the acquisitions are complete.

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11. Property Description

§7.94 a. Importance of Correct Description

A correct description of the property to be conveyed is an essential aspect of a sales transaction. In many residential transactions, the buyer does not obtain or rely on an existing survey to confirm the accuracy of the description in the purchase agreement and the deed. Without a survey, the buyer may not be able to confirm that the property described in the policy is the property the buyer has seen or that exists on the ground. The maps attached to the preliminary report and to most policies are stamped with disclaimers of accuracy. The title policies insure only "what is described" and limit claims responsibility to the boundaries specified in the policy. The boundaries may be correct but may leave gaps unknown to the buyer.

One protection, of course, is to obtain a survey and an ALTA extended coverage policy, but even in these instances (particularly if the property is not described by reference to the survey), commercial owners commonly request a CLTA 116 endorsement. On limitations on the CLTA 116 endorsement, see §8.93; *Golden Sec. Thrift & Loan Ass'n v First Am. Title Ins. Co.* (1997) 53 CA4th 250, 61 CR2d 442.

NOTE: CLTA 116 endorsements, typically issued in favor of lenders, are rarely issued in favor of owners, given the additional risks involved.

An owner may obtain one of several endorsements designed to insure the accuracy of the policy's property description.

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§7.95 b. CLTA 116.1, 116.2, 116.3, and 116.7 Endorsements

The following CLTA endorsements ensure the owner that the land described:

- Is as shown on a specified plat or survey (CLTA 116.1 endorsement);
- Is improved with the condominium being insured, and the condominium is correctly shown on the plat (CLTA 116.2 endorsement);
- Is part of an identified subdivision (CLTA 116.3 endorsement); and
- Was lawfully created under the Subdivision Map Act (Govt C §§66410-66499.37) and local ordinances adopted under that Act (CLTA 116.7 endorsement).

PRACTICE TIP: The CLTA 116.7 endorsement should be considered whenever property is described by a metes and bounds description instead of by a parcel number from a recorded parcel map or by a lot in a tract map.

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§7.96 c. Underwriting Criteria

Before issuing these endorsements, the insurer will confirm the description by reviewing the following and comparing them with the property description in the title report:

- The survey (for a CLTA 116.1 endorsement);
- The condominium map (for a CLTA 116.2 endorsement);
- The subdivision or parcel map (for a CLTA 116.3 endorsement); and
- The recorded tract or parcel map (for a CLTA 116.7 endorsement).

Alternatively, the CLTA 116.7 endorsement may be available if there is (1) a recorded certificate of compliance and (2) a long-standing metes and bounds description.

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12. Zoning

§7.97 a. CLTA 123.1 (ALTA Form 3) and 123.2 (ALTA Form 3.1) Endorsements

A commercial owner or developer may wish insurance that unimproved land meets certain zoning classifications. The CLTA endorsement 123.1 specifies the zoning classification for the property and uses permitted under the classification, subject to compliance with applicable CC&Rs, including obtaining necessary permits. The CLTA 123.2 endorsement contains the same language as the CLTA 123.1 endorsement, plus it insures against a final judgment that either prohibits use of the land with the existing structure or requires alteration or removal of the existing structure based on ordinance violations in area, width, depth, floor space, setbacks, or height. Both endorsements exclude any marketability claims arising from a refusal to perform under a contract to purchase, lease, or lend.

Many owners request that the zoning endorsements be modified to add ordinance violations relating to parking requirements. An ALTA survey may also state the number of parking spaces required by zoning law and the number of parking spaces planned or existing.

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§7.98 b. Underwriting Criteria

Before issuing a CLTA 123.1 or 123.2 endorsement, the insurer usually examines local zoning ordinances and zoning maps to ascertain allowable uses and classifications. It may request the insured to obtain a letter from the local governmental agency stating the zoning classification and the permitted uses. For an existing structure, the underwriter may also require an inspection of the property and a review of surveys and existing plans. If parking requirements are to be added to the zoning endorsement, the title company may require that the survey designate the number of parking spaces on the site. These endorsements are expensive and, therefore, are seldom requested by owners except in high liability transactions where an owner often prefers to pay for an endorsement and have the option to pursue a title insurance claim, rather than rely on a zoning letter issued by local agency officials.

PRACTICE TIP: Counsel should keep in mind if requesting a zoning letter that some municipalities will refuse to issue them and others take several weeks to do so. Consequently, it is important to plan ahead and submit a proposed letter to the municipality as soon as possible to avoid delaying closing.

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§7.99 C. ALTA Endorsements

The ALTA has its own series of endorsements. Although most ALTA endorsements protect the priority of the lender, some deal with issues important to the owner, such as:

- Zoning assurances (ALTA 3 and 3.1 endorsements, identical to the CLTA 123.1 and 123.2 endorsements, respectively);
- Matters affecting condominiums (ALTA 4 and 4.1 endorsements, identical to the CLTA 115.1 endorsement); and
- Matters affecting planned unit developments (ALTA 5 and 5.1 endorsements, identical to the CLTA 115.2 endorsement).

For the owner, these endorsements are similar in scope to the CLTA endorsements. The ALTA endorsements may not be readily found in the endorsement books of local title companies. The forms can be found in the Appendix to Burke, Law of Title Insurance (3d ed 2000). For a complete list of ALTA endorsements and their CLTA counterparts, see §8.102.

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§7.100 D. Title Insurance Company Endorsement Forms

A title insurance company may offer additional endorsements identified by the title insurance company's individual designation. For example, title insurance companies market a variation of the CLTA 126.1 homeowner's endorsement with their own corporate names attached. Most title insurance company endorsements were designed to meet the needs of unique lending situations, such as revolving lines of credit or shared appreciation mortgages.

PRACTICE TIP: When counsel requests an endorsement to insure against a unique title problem, the insurer will evaluate the risk and make the underwriting decision based on both the facts and the law. Counsel should be prepared to disclose all facts surrounding the nature of the risk. Evaluation of these facts is a necessary support for any legal analysis of the absence of a risk. Title insurance is founded on the theory that products offered to the insured are designed to eliminate, rather than undertake, risk.

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1. Nonimputation Endorsement

§7.101 a. Purpose of Endorsement

An endorsement may be needed if an additional named insured is added to the policy or if a new entity consists of a partner who was previously involved with the property and a partner who is new to the property. The policy does not cover certain matters known by the insured and not disclosed in writing to the insurer as of the date of the policy (exclusion 3(b)). Facts known to an insured who is familiar with the property may be imputed to an insured who is not familiar with the property. A nonimputation endorsement prohibits the title insurer from imputing knowledge of the new insured to the existing insured.

EXAMPLE: Assume that *X*, the owner of insured property, sells it to a partnership composed of *X*, *Y*, and *Z*. The partnership will want new insurance with a nonimputation endorsement so that *X*'s knowledge of matters affecting the insured property will not be imputed to the partnership.

This endorsement may also be issued in connection with a stock purchase. Concurrently with obtaining the nonimputation endorsement, many insureds also obtain the Fairway endorsement. See §7.103A.

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§7.102 b. Underwriting Criteria

The endorsement is usually issued only after an investigation of the circumstances of the transaction. The underwriter will want an affidavit from each partner (or each officer if a corporate entity), confirming the affiant's lack of knowledge of any title risks not disclosed in the preliminary report or title policy. An indemnity may also be required from outgoing and remaining partners or shareholders to back up the indemnity. Financial statements may be required from affiants.

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§7.103 2. Inflation Endorsement

The inflation protection endorsement is another endorsement marketed by individual title insurance companies. For discussion of this endorsement, see §§7.68-7.69.

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§7.103A 3. Fairway Endorsement

If a partnership or limited liability company is acquiring property, the Fairway endorsement is available to insure that the title policy coverage continues in effect even though a new partner or member is admitted or an existing partner or member withdraws from the partnership or limited liability company or there is a change in any partner's or member's interest in the capital or profits of the partnership or limited liability company.

PRACTICE TIP: Concurrently with obtaining the Fairway endorsement, many insureds also obtain the nonimputation endorsement. See §§7.101-7.102.

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§7.104 VI. POSTCLOSING REVIEW

Title policies are received *after* close of escrow. Once received, frequently weeks after closing, counsel or the client should compare the policy with the title instructions to confirm that the following are correct:

- The form of the policy (whether ALTA or CLTA);
- The description of the property;
- The date of the policy;
- The insured amount;
- The policy number;
- Vesting of the insured owner;
- Identification of the estate; and
- Approved exceptions from the preliminary report and title instructions.

Endorsements should be checked to confirm their correlation to the policy issued because endorsements intended for a lender's policy may be inadvertently attached to the owner's policy.

The policy should be checked for mistakes, typographical errors, or any changes to the wording of exceptions not approved by the client. If the policy is incorrect but the insured fails to object to it in a timely manner following its receipt, the insured risks being bound by the terms of the policy as issued. See *Hackethal v National Cas. Co.* (1987) 189 CA3d 1102, 234 CR 853.

See also §10.20 on reviewing the title policy.

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8

Lender's Policies and Endorsements

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I. THE LENDING INDUSTRY AND ITS REQUIREMENTS

A. General Considerations

§8.1 1. Lender's Goals

The lender requires title insurance to protect certain expectations about real property collateral. The lender's chief goals regarding title insurance are to obtain assurances that:

- The priority of its lien is not lower than the lender expected; and
- If the lender forecloses on its collateral, the buyer at the foreclosure sale (usually the foreclosing lender) will have title to property that can be sold practically.

EXAMPLE: To sell the property practically, a lender's collateral should include any easements necessary for ingress, egress, and parking, and there should be no encroachments that must be removed before the property can be sold.

In theory, all lender requirements with respect to title insurance flow directly or indirectly from these two fundamental goals.

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§8.2 2. Borrower's Goals

The borrower's fundamental goals differ from the lender's goals. See §8.1. With respect to title insurance, a borrower generally wants to:

- Limit the cost of the lending transaction; and
- Avoid undue delay.

As a rule, the borrower pays the cost of the lender's title insurance policy. Endorsements are priced separately from title insurance policies and add to the cost of title insurance. Although some endorsements are free, or nearly so, others can cost as much as the policy itself. Further, a title insurer will remove an exception to title insurance coverage only if it is satisfied with the result of its underwriting investigation. This investigation may require a survey of the insured property, which is expensive. The survey's cost is usually borne by the borrower. On lender's endorsements, see §§8.50-8.118. On surveys, see §§4.30-4.34.

While the borrower wants to avoid undue delay in closing the loan, the lender's title insurance requirements take time, *e.g.,* reviewing surveys and undertaking the due diligence necessary to remove exceptions to coverage or issue endorsements. Lenders typically refuse to close loans until:

- All title and title insurance matters are resolved;
- The required title insurance has been issued or the title insurer is irrevocably committed to do so; and
- The funds to pay the title insurance premium are in escrow.

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§8.3 3. Impact of Third Parties on Lender's Title Insurance Requirements

If the only parties to the transaction are the lender and the borrower, the borrower may be able to persuade the lender that its concerns can be addressed by means other than obtaining expensive title insurance endorsements or surveys. For example, a borrower may be able to persuade the lender that certain exceptions to title pose no real threat to the lender in the particular circumstances.

Many loan transactions, however, involve actual or contemplated third parties. Today, lenders often obtain funding to make loans not by using the funds deposited with them in savings accounts, but by selling loans. Loans may be sold singly or in pools and may even be "securitized" (*i.e.*, bundled for sale as a group). See §§8.7-8.12. Typically, when a loan or a pool of loans is securitized, debt or equity securities secured or otherwise supported by the loan or pool are issued and sold either to the public or in private placements.

If a lender wishes to sell a loan or to preserve the ability to do so at a later date, the borrower may find the lender's title insurance requirements more conservative and have less success in negotiating a change to those requirements.

In such instances, the lender's position on title insurance derives largely from the market in which the loan will or may be sold. Often, the loan may have to be documented under standards set by the market. Even if the market in which the loan will be sold lacks clear standards, the lender may impose stricter title insurance requirements with respect to a loan that it intends to sell. More conservative title insurance requirements can enhance the marketability of a loan to persons who are less familiar with the collateral and the borrower than is the lender who originated the loan.

In most loan sales, a lender is required to give some representations and warranties about the loan. Although each transaction is different, the following are relatively common representations and warranties:

- The loan, and the lien that secures it, are enforceable in accordance with their terms;
- The borrower has good title to the real property;
- The priority of the lien is as represented;
- There are no title exceptions that materially affect the borrower's ability to repay the loan; and
- There are no material impediments either to foreclosure or to the value of the real property security.

Lenders may be required to repurchase a loan or to pay damages to the purchaser if the representations and warranties later prove to be false. Lenders require title insurance in part to mitigate some of the risks that arise from the representations and warranties that they are required to give in connection with a sale of the loan.

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§8.4 B. FNMA/FHMC Requirements

The Federal National Mortgage Association (Fannie Mae), established in 1958 under the National Housing Act (12 USC §§1701-1750g), and the Federal Home Loan Mortgage Corporation (Freddie Mac), established in 1970 under the Emergency Home Finance Act (12 USC §§1451-1459), are quasi-governmental entities. Both Fannie Mae and Freddie Mac purchase residential mortgage loans singly, in pools, or in portions. Each entity imposes guidelines for documenting and underwriting loans it will purchase, including the title insurance required. Although each entity's requirements and programs differ, they are sufficiently similar that they will be treated jointly for purposes of this chapter. On Freddie Mac and Fannie Mae generally, see California Real Estate Finance Practice: Strategies and Forms §4.2 (Cal CEB 2000).

Even if lenders have no immediate plans to sell loans, residential mortgage loans often comply with Fannie Mae and Freddie Mac guidelines so that the loans will be readily salable in the secondary market.

Fannie Mae and Freddie Mac may retain ownership of the loans purchased for their own benefit. Alternatively, either entity may securitize the loans. See §§8.7-8.12. Guidelines for purchase of loans by Fannie Mae and Freddie Mac do not differentiate between loans based on whether the entity expects to securitize the loans.

Absent special arrangements with a lender, both Fannie Mae and Freddie Mac usually require an ALTA lender's policy.

PRACTICE TIP: Both Fannie Mae and Freddie Mac publish guides describing their standards for the various types of loans they buy. Counsel with questions about title insurance requirements for various Fannie Mae and Freddie Mac loans should consult the applicable guide. Current Freddie Mac title insurance requirements for single-family homes are in 1 Freddie Mac Single-Family Seller/Servicer Guide, chap 39 (1996; regularly updated), and Fannie Mae title insurance requirements are in Fannie Mae's Selling Guide, Part IV, §105 (rev ed 1994; regularly updated). See Directory for telephone numbers for Fannie Mae and Freddie Mac.

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§8.5 C. Loan Pools, Participations, and Securitized Transactions

Sections 8.6-8.12 discuss loans that are to be packaged in pools or securitized but that do not comply with the Fannie Mae or Freddie Mac standards, either because they are secured by commercial property or because they present higher levels of risk than loans conforming to Fannie Mae and Freddie Mac requirements. The requirements for documenting and underwriting these loans, including title insurance requirements, are governed by the demands of the market in which the loans will be sold.

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§8.6 1. Packaging Loans

Lenders may package loans into groups or pools for a variety of reasons (other than for sale to Fannie Mae or Freddie Mac; see §8.4). A lender may later sell the pool as a whole or interests in the pool. If several lenders own shares of a pool, their relationship is sometimes known as a "participation." Occasionally, several lenders participate in a single loan or lending relationship consisting of several types of loans to a single borrower.

The lender's title insurance requirements in loan pools and participations are often shaped by typical representations and warranties required in sales of similar loans. As in other loan sales, lenders that intend to sell all or portions of loans may impose stricter title insurance requirements than other lenders do. For examples of typical representations and warranties, see §8.3.

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§8.7 2. Securitizing Loans

In the last 20 years, a multi-billion dollar market developed for interests in "securitized" loans or pools of loans. See §8.3. Debt or equity securities secured or otherwise supported by these loans or pools of loans are sold either in private placements to selected investors or in public offerings to the public, much as bonds and other securities are sold. For a detailed discussion of securitized loans, see California Real Estate Finance Practice: Strategies and Forms, chap 10 (Cal CEB 2000).

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§8.8 a. Evolving Market

The market for bonds backed by loans other than Fannie Mae and Freddie Mac loans has evolved and continues to evolve rapidly as the appetite of the marketplace, market stresses, and available investment alternatives change and, with it, the documentation and underwriting requirements for the underlying loans. Requirements for loans that have been in the marketplace longer, such as loans to credit-worthy borrowers secured by first priority liens on fully leased commercial real estate, may be relatively stable. Requirements for other loans, such as loans to high-risk (subprime) borrowers or loans secured by second deeds of trust, are subject to more negotiation. Requirements for both types of loans have been subject to reevaluation and change during the global financial crisis of 2008-2009. See California Real Estate Finance Practice: Strategies and Forms §§10.26-10.26C (Cal CEB 2000).

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Source: Real Property/California Title Insurance Practice/8 Lender's Policies and Endorsements/§8.9 b. Establishing Title Insurance Requirements

§8.9 b. Establishing Title Insurance Requirements

The title insurance and other requirements for loans that will be securitized are established by the lender and the other principal players in a securitization.

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§8.10 (1) Rating Agency

A rating agency, such as Standard & Poor's or Moody's Investors Service, gives the bonds a rating, which has a significant impact on the interest rate the bonds must pay in order to be marketable. Rating agencies have guidelines, including guidelines for title insurance and title insurers, that they follow in evaluating the loans for purposes of rating the bonds backed by the loans. The rating agencies' guidelines are sometimes applied more flexibly than are Fannie Mae and Freddie Mac guidelines because the types of loans being securitized cover a broader range than Fannie Mae and Freddie Mac permit. For more on rating agencies and their role in the financial crisis of 2008-2009, see California Real Estate Finance Practice: Strategies and Forms §10.7 (Cal CEB 2000).

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§8.11 (2) Underwriter of Bonds

If the loans in the pool are not of a commonly accepted type, the lender may negotiate with the bond underwriter to set (a) the parameters of loans that may be included in the pool that will back the bonds and (b) the terms of the agreement that will govern the bonds. In this negotiation, the underwriter may consult with likely purchasers of the bonds, such as institutional investors, to ascertain the standards that will be acceptable to the intended universe of buyers.

EXAMPLE: The underwriter may find that potential buyers require minimal or no title insurance for small second mortgage loans subject to large first mortgage loans because the buyers essentially treat those loans as unsecured.

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§8.12 (3) Issuers of Credit Enhancements

The lender may arrange for a credit enhancement, such as a bond, standby letter of credit, or credit default swap, to help assure bondholders that the lender will perform its obligations and covenants under the agreement that governs the terms of the bonds. This arrangement helps support the rating of the bonds issued by the lender.

PRACTICE TIP: Counsel faced with title insurance questions in a loan pool, participation, or securitization context should obtain up-to-date information from persons currently active in the marketplace. For securitizations, this includes rating agencies and underwriters. See California Real Estate Finance Practice: Strategies and Forms chap 10 (Cal CEB 2000).

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D. Priority of Deed of Trust

§8.13 1. Recordation

The lender's deed of trust (and any other recorded loan document, *e.g.,* a fixture filing or assignment of rents) takes its priority as of the date and time it is recorded in the office of the county recorder where the property is located. Generally, the lien of the deed of trust is prior and superior to interests in real property recorded after it. Exceptions to this rule are discussed in §§8.14-8.16. On recordation in general, see California Real Property Sales Transactions §§15.85-15.96 (4th ed Cal CEB 2007).

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2. Exceptions to Priority by Recordation

§8.14 a. Actual Notice

Recordation creates constructive notice. CC §1213. The lender's recorded deed of trust will be subordinate, however, to any unrecorded interest in real property of which the lender has actual notice. CC §1217.

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§8.15 b. Real Property Taxes and Certain Assessments

The lien for ad valorem real property taxes is superior to preexisting recorded private liens. Rev & T C §2192.1. Public improvement assessments declared by law to be a lien on real property are superior to other liens regardless of when they were created. Rev & T C §2192.1. The lien for the assessments of the Municipal Improvement Act of 1913 (Str & H C §§10000-10706), the Improvement Bond Act of 1915 (Str & H C §§8500-8887), and the Mello-Roos Facilities District (Govt C §53311), arising anew each year, take priority over all security interests if they have been properly created and if a notice of special tax lien was previously recorded. Rev & T C §2192.1. On special assessments, see California Real Property Sales Transactions §4.63 (4th ed Cal CEB 2007).

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§8.16 c. Mechanics' Liens

Mechanics' liens become valid on recordation of a notice of lien. CC §§3115-3117. The priority of mechanics' liens relates back to the date of commencement of the work of improvement. CC §3134. If a deed of trust is recorded before recordation of a notice of lien but after commencement of construction, all mechanics' liens relating to the work of improvement have priority. For further discussion of the priority of mechanics' liens, see California Mechanics' Liens and Related Construction Remedies §§2.63-2.74 (3d ed Cal CEB 1998).

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§8.17 3. Prior Interests That May Be Advantageous to Lender

Generally, a lender requires that its lien be superior to all other liens and encumbrances. If there is a prior interest that increases the value or is important to the development of the property (*e.g.,* a utility or an access easement), the lender typically agrees to subordinate its lien to that interest. Additional examples of such interests include:

- Leases (see §§8.18-8.21);
- Covenants, conditions, and restrictions (CC&Rs) (see §§8.22-8.23); and
- Reciprocal easement agreements (REAs) (see §§8.24-8.25).

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a. Leases

§8.18 (1) Lender's Considerations

A lease recorded before recordation of the deed of trust would not be eliminated by foreclosure of the lien of the deed of trust. If a lender requires that the lien of the deed of trust be superior to the recorded lease, a written subordination agreement is needed. See §8.19. But if the lender is relying on the rents from the lease for repayment of the loan, it may not want to destroy the lease by foreclosure. In that event, a subordination, nondisturbance, and attornment agreement may be used. See §8.20.

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§8.19 (2) Lease Subordination

Many leases contain automatic subordination clauses in which the lessee subordinates its leasehold interest to any future financing without reference to any specific terms of the future deed of trust. For a comprehensive discussion of automatic subordination clauses, see Office Leasing: Drafting and Negotiating the Lease §§28.2, 28.6 (Cal CEB 1996).

Although automatic subordination clauses were upheld in *Dover Mobile Estates v Fiber Form Prods.* (1990) 220 CA3d 1494, 270 CR 183, some title companies are still reluctant to rely on an automatic subordination clause to insure a deed of trust's priority over a lease that was executed before the deed of trust, if the lease does not specifically identify the loan to which it will be subordinate. Title companies may continue to require lenders to obtain subordination agreements that specifically identify the loan and unconditionally subordinate the lease to the lien of the deed of trust. The CLTA has promulgated a form of such a subordination, which title insurance companies accept.

PRACTICE TIP: When making the loan, lender's counsel should confirm that the lender wants any existing leases containing an automatic subordination clause to be subordinated to the deed of trust. In *Dover Mobile Estates v Fiber Form Prods.* (1990) 220 CA3d 1494, 270 CR 183, the lender, after foreclosure, attempted but failed to compel a tenant to remain in the premises. The court held that, because of the automatic subordination language in the lease, the foreclosure of the deed of trust eliminated the lien of the prior recorded lease. Although the lender did have an option to make the lease superior to the lien of the deed of trust, the lender failed to exercise that option. Lender's counsel will also need to consider the effect of the holding in *Miscione v Barton Dev. Co.* (1997) 52 CA4th 1320, 61 CR2d 280, in which the court held that the attornment provisions of a lease may reorder the priorities of the junior lease if a senior lienholder elects to enforce the attornment provision after the foreclosure. The court so held even though the senior lienholder did not elect before the foreclosure to treat the lease as being senior to its deed of trust under the automatic subordination provisions of the lease. A similar result was upheld in *Principal Mut. Life Ins. Co. v Vars*, *Pave, McCord & Freedman* (1998) 65 CA4th 1469, 77 CR2d 479, based on different reasoning, which is discussed further in §5.15. In addition, it is important to note the holding of the *Principal* case, which restricts the use of unilateral subordinations by lenders, if the lease does not affirmatively provide for such subordinations. Title companies may be pressed by lenders and foreclosure purchasers to make determinations concerning priorities and competing lease provisions. Lenders and foreclosure purchasers may begin requesting title companies to evaluate lease provisions and pre- and post-foreclosure actions by the lender and the tenant, to determine the priority and continuing validity of leases. See §8.82.

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§8.20 (3) Subordination, Nondisturbance, and Attornment Agreement

A lender who wants to preserve the lease after foreclosure can enter into a subordination, nondisturbance, and attornment agreement in which the lease is subordinated, but the lender agrees not to disturb the lease in the event of foreclosure (assuming that the lessee is not in default), and the lessee agrees to accept the purchaser at the foreclosure as the new owner/lessor under the lease. On subordination, nondisturbance, and attornment agreements generally, see Retail Leasing: Drafting and Negotiating the Lease, chap 44 (Cal CEB 2007); Office Leasing: Drafting and Negotiating the Lease, chap 18 (Cal CEB 1996).

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§8.21 (4) Title Insurance

The prior recorded lease is shown as a subordinate item (in Part II, Schedule B of the ALTA lender's policy) if the lessee executes a subordination agreement. If a subordination, nondisturbance, and attornment agreement is used, the lease is shown as subordinate to the deed of trust (in Part II, Schedule B of the ALTA lender's policy), but the deed of trust is shown as subordinate to the nondisturbance rights of the tenant (in Part I, Schedule B of the ALTA lender's policy).

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b. Covenants, Conditions, and Restrictions (CC&Rs)

§8.22 (1) Lender's Considerations and Priorities

The CC&Rs take their priority as of the date of their recordation. Frequently, the CC&Rs are recorded before the deed of trust. Even if the CC&Rs benefit the property, the lender will not want the deed of trust to be subject to assessment liens arising from nonpayment of the owners' association obligations. Assessment liens take their priority as of the date of the recordation of a notice of delinquent assessment. CC §§1367 (applicable to liens recorded after Dec. 31, 1985, and before Jan. 1, 2003), 1367.1 (applicable to liens recorded after Dec. 31, 2002). The lender also usually wants assurances in the document that no violation of the CC&Rs will impair the lien of the deed of trust.

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§8.23 (2) Title Insurance

The CLTA 100 endorsement insures against loss by reason of a number of issues related to the CC&Rs, including present and future violations of the CC&Rs. See §8.54. On other endorsements regarding CC&Rs, see §§8.71-8.72.

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c. Reciprocal Easement Agreements (REAs)

§8.24 (1) Lender's Considerations and Priorities

A reciprocal easement agreement (REA) both benefits and burdens the property encumbered by the deed of trust. An REA is used to effectively develop sites containing multiple contiguous lots that are owned, leased, or developed by different owners (*e.g.*, shopping centers, industrial parks, and multi-phased residential developments).

The REA takes its priority as of the date it is recorded. A subsequently recorded deed of trust encumbers the easement that is appurtenant to the encumbered property and is subject to the easement that burdens the encumbered property. A subordination of the REA to the deed of trust is undesirable because a foreclosure of the lien of the deed of trust would destroy the REA and threaten the viability of the development and the value of the lender's security.

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§8.25 (2) Title Insurance

In the insured lender's policy, the easements created by the REA that are appurtenant to the encumbered property will appear as additional insured parcels.

PRACTICE TIP: Lender's counsel should carefully note matters having priority over those easements (*e.g.*, other liens) to make sure that the easement rights are not inadvertently destroyed.

The easements created by the REA that burden the encumbered property will appear as an exception in Part I, Schedule B of the ALTA lender's policy.

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II. DIFFERENT FORMS OF LENDER'S POLICIES

§8.26 A. Introduction to Lender's Policies

Most lenders insist on obtaining a title insurance policy to insure the priority of their recorded deed of trust. Because the borrower usually pays the title insurance premium, most lenders demand the extended coverage afforded by the ALTA lender's policy. See §6.8. In a claims situation, the ALTA lender's policy provides greater protection against title risks than does the CLTA standard coverage policy. Many of the terms and conditions of the various lender title policy forms contain similar language. The remainder of this chapter focuses on the different products adopted by the title industry to insure a lender. (Most policies repeatedly speak in terms of the insured "mortgage," which is defined in the conditions and stipulations to include a mortgage, a deed of trust, or other security instrument. Because "deeds of trust" are commonly used in California, that term will be used in this chapter.) Many of the unique coverages available to the insured lender are found in the various endorsements (see §§8.50-8.118) that can be ordered with the policy or at a future date, as with a modification or an advance under a loan instrument.

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§8.27 B. CLTA Policy

Chapters 6 and 7 discuss various aspects of the 1990 CLTA standard coverage policy (CLTA policy), mainly with respect to coverage for an insured owner. The CLTA policy can also be issued to ensure a lender that the provisions affecting the lender are the same regardless of whether the policy is issued to the lender separately or is jointly issued to the lender and the owner. See App H for a copy of the CLTA policy.

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§8.28 1. Coverage

The CLTA policy is designed to cover only specific "record title" matters. See §7.22. It does not insure matters involving "off-record" title risks such as easements, encroachments, boundary problems, matters ascertainable by inspection, or other matters excluded under Schedule B, Part I of the CLTA policy. See §§6.7, 6.51. These exceptions for off-record matters are not found in the 1992 ALTA loan policy (ALTA lender's policy) and are the chief distinction between the two policies.

The insuring provisions of the CLTA policy contain the following coverages for an insured lender only:

- Invalidity or unenforceability of the lien of the insured deed of trust on the title (see §6.28);
- Priority of any lien or encumbrance over that of the insured deed of trust, except matters shown in Schedule B "in the order of its priority" (see §6.29); and
- Invalidity or unenforceability of any assignment of the insured deed of trust shown in Schedule B or the failure of an assignment reflected in Schedule B to vest title to the insured deed of trust in the assignee free and clear of all liens (see §6.32).

On the CLTA policy generally, see chap 6, §§7.11-7.35.

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§8.29 2. 1973 and 1990 CLTA Policies Compared

The 1990 CLTA policy added:

- An exclusion for the insured lender's failure to comply with applicable "doing-business" laws (exclusion 4); and
- A creditors' rights exclusion (exclusion 6).

(The ALTA lender's policy also contains both exclusions, although the language of the creditors' rights exclusion is more detailed, referring to claims of equitable subordination, fraudulent transfers, or preferential transfers (exclusion 7). See §8.32.) On the doing-business law exclusion, see §6.46; on the doing-business law endorsement, see §§8.104-8.105; on creditors' rights exclusion, see §§6.48, 6.88, 7.18-7.20, 8.32, 11.78.

Other changes made to the 1990 CLTA policy clarify the language of the 1973 CLTA policy, making it similar to the ALTA lender's policy, but create no significant differences. For instance, the 1973 CLTA policy insured against the "invalidity" of the insured deed of trust (insuring clause 5), while the 1990 CLTA policy insures against the "invalidity or unenforceability" of the insured deed of trust.

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C. 1992 ALTA Lender's Policy

§8.30 1. Coverage

The 1992 ALTA loan policy (ALTA lender's policy) is designed to provide certain "off-record" protection for the lender, putting the risk of physical inspections or survey matters on the insurer. This does not mean that an inspection will in fact occur, only that the lender is indemnified against actual loss for matters that may arise in a claims situation that could, for instance, have been disclosed by an inspection or a survey. While the insuring clauses on the face page of the 1992 ALTA lender's policy are similar to those in other policies, the 1992 ALTA lender's policy is designed to insure the validity and enforceability of the lien of the insured deed of trust instrument on the vested title (insuring clause 5) as well as the priority of the insured deed of trust lien (insuring clause 6). For a copy of the 1992 ALTA lender's policy, see App I. For a comparison of the 1970 and 1992 ALTA lender's policies, see §§6.85-6.88, 8.32-8.33. For a comparison of the 1992 and 2006 ALTA lender's policies, see §8.33A-8.33I. For a copy of the 2006 policy, see App J.

Subject to the exceptions and exclusions to the policy, the 1992 ALTA lender's policy also insures:

- Vesting of the title of the named owner (see §6.22);
- Against any defect or lien or encumbrance on the title (see §6.23);
- Marketability of title (see §§6.24-6.26);
- Against lack of a right of access (see §6.27);
- Priority of the insured deed of trust over mechanics' liens arising from a prepolicy work of improvement, or a post-policy mechanics' lien financed by proceeds of the insured loan that the lender is obligated to advance or has advanced (see §6.30);
- Priority of the insured deed of trust over street assessments under construction or completed at the date of the policy (see §6.31); and
- Validity and enforceability of an assignment of the deed of trust reflected in Schedule A of the policy (see §6.32).

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§8.31 2. Exclusions

The exclusions in the 1992 ALTA lender's policy are similar to those in other policies. See §§6.34-6.48. Lenders are particularly concerned about exclusions relating to:

- Failure to comply with "doing-business laws" (see §6.46);
- Usury, consumer credit, or truth-in-lending laws (see §6.46);
- Mechanics' liens for works of improvement begun after the date of the policy and not financed by an obligatory advance of the insured lender (see §6.47); and
- Creditors' rights (see §§6.48, 6.88, 7.18-7.20, 8.32, 11.78).

See §8.33C for discussion of the 2006 ALTA lender's policy exclusions.

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3. 1970 and 1992 ALTA Lender's Policies Compared

§8.32 a. Creditors' Rights Exclusion

The creditors' rights exclusion of the 1992 ALTA lender's policy (Exclusion 7), which is not in the 1970 ALTA lender's policy, is one reason some lenders insist on the issuance of a 1970 ALTA lender's policy. Be aware, however, that it is not entirely clear what coverage an insured has in the absence of the creditors' rights exclusion, because title insurance companies believe that creditors' claims were not covered by the 1970 policy language.

The creditors' rights exclusion excludes certain claims arising from the operation of federal bankruptcy or state insolvency laws involving fraudulent conveyances, the doctrine of equitable subordination, or certain preferential transfers. Lender's counsel should request the title insurance company to delete this exclusion by endorsement. The availability of this endorsement depends on whether the company's underwriting analysis finds that the transaction is subject to the risks excluded by the creditors' rights exclusion. The cost of the endorsement, if available, will vary depending on the risk. In addition, any reinsurers involved may require an additional premium. If a proposed insured requests the deletion of this exclusion, the title insurance company will require additional information about the proposed loan transaction to help it evaluate the risk involved. Such information might include assurances of the borrower's solvency and the adequacy of consideration in the particular transaction (*e.g.,* insurers may require an appraisal of the subject property, demonstrating that reasonably equivalent value was given). When creditors' rights risks are present, the insurer will probably decline to remove the exclusion.

Creditors' rights risks are not typically present in a customary lending transaction where the borrower is also the owner of the property pledged to secure the debt. After a foreclosure sale, title insurance companies may agree to the deletion of the creditors' rights exclusion based on the holding of *BFP v Resolution Trust Corp.* (1994) 511 US 531, 128 L Ed 2d 556, 114 S Ct 1757, which held that a regularly conducted foreclosure sale would establish "reasonably equivalent value" in a fraudulent transfer action seeking to avoid a foreclosure sale. However, in the case of title acquired through a deed in lieu of foreclosure, the title insurer may require that an appraisal be given to demonstrate reasonably equivalent value.

EXAMPLE: Assume that a lender makes an unsecured loan. At a later time, the lender requests the borrower to execute and deliver a deed of trust to secure the existing loan, and requests an ALTA lender's policy for its deed of trust. The title insurance company may refuse to issue an endorsement deleting the creditor's rights exclusion from its policy because of the risk that the grant by the borrower of the deed of trust on account of an "antecedent" debt could be subject to attack as a preferential transfer.

If a title insurance company will not agree to delete the exclusion immediately, it may agree to issue an endorsement that automatically deletes the creditors' rights exclusion after a stated period of time if no bankruptcy petition has been filed. In addition, an insured may succeed in having this language deleted from a policy or a binder purchased by a lender on acquisition through foreclosure or deed in lieu of foreclosure for transfers to a future third party bona fide purchaser.

NOTE: Some title insurance companies may also justify the existence of the creditors' rights exclusions by categorizing a postpolicy bankruptcy as an event subsequent to the date of the policy that is not covered (see §6.44). However, although the bankruptcy action itself occurs after the date of the policy, if it operates to set aside the insured transaction, it relates back to this date, and this argument should not prevail.

For further discussion of creditors' rights exclusions, see §§6.48, 6.88, 7.18-7.20, 11.78.

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§8.33 b. Arbitration

Another objection raised by lenders to the 1992 ALTA lender's policy relates to the arbitration clause, which was added as Condition 13. It provides that matters are arbitrable at the option of the insurer or insured when the amount of insurance is under $1 million. When policy liability is over $1 million, arbitration requires the consent of both insurer and insured. If the 1992 ALTA lender's policy is used, an endorsement is available to delete this provision. See §§6.83, 6.87, 7.33. See §8.33D for discussion of the arbitration clause in the 2006 ALTA lender's policy.

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§8.33A 4. 1992 and 2006 ALTA Lender's Policies Compared

Like the 1992 version, the 2006 ALTA loan policy is designed to be used as an extended coverage policy to protect lenders from loss of their security interest in property as a result of defects in title. The two policies are compared in §§8.33B-8.33I.

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§8.33B a. Expansion of Covered Risks

Attorneys who deal with first party property coverages are familiar with "Covered Causes of Loss," such as fire and flood, which are covered under the policy. The 1992 loan policy has no such name for the affirmative insuring provisions. The 2006 loan policy denotes them as "Covered Risks."

The principal difference between the 2006 and 1992 loan policies may be the positive approach to clarifying coverage that is afforded by the new policy form. The 1992 loan policy contains several exceptions to exclusions. Apparently, ALTA intended that title defects falling within an exception to an exclusion would be covered. However, some courts, applying the rule that an exception to an exclusion cannot create coverage (see, *e.g., Elysian Inv. Group v. Stewart Title Guar. Co*. (2002) 105 CA4th 315, 324, 129 CR2d 372), interpreted certain coverages narrowly. The 2006 loan policy eliminates the exceptions or limitations to the exclusions, and adds former exceptions as "Covered Risks." For example, mechanics' lien coverage now appears as Covered Risk 11(a), rather than as an exception to Exclusion 6 in the 1992 policy. Further, the title industry has viewed fraud and forgery as covered even though not specifically mentioned in the 1970, 1990, or 1992 loan policies. The 2006 loan policy specifies that "fraud" and "forgery" are covered risks. See App J, Covered Risk 2(a)(i).

As a result of the new approach, the 2006 loan policy contains 14 covered risks, compared to only eight in the 1992 loan policy.

NOTE: Some title companies included an insuring clause that in substance is the same as the ALTA form 1 endorsement for street assessments, resulting in nine covered risks in the 1992 loan policy rather than eight. See App I.

The covered risks in the 2006 loan policy are:

1. Title vested other than as stated in Schedule A (see §6.22);
2. Any defect in or lien or encumbrance on title (see §6.23);
3. Unmarketable title (see §§6.24-6.26);
4. No right of access (see §6.27);
5. Violation or enforcement of police powers laws, ordinances, permits and regulations relating to building and zoning, subdivisions, and environmental protection if notice of violation or intention to enforce is recorded in the public record (see §6.36);
6. Enforcement of police powers other than those noted in Covered Risk 5 if notice of enforcement appears in the public records (see §6.37);
7. Exercise of eminent domain power if notice of exercise is recorded in the public records (see §6.39);
8. Prior taking by a governmental body that is binding on a bona fide purchaser for value and without notice (see §6.39);
9. Invalidity or unenforceability of the lien of the insured mortgage (see §6.28);
10. Lack of priority of the lien of the insured mortgage over any other lien or encumbrance (see §6.29);
11. Mechanics' lien and special assessment coverage (see §§6.30, 6.31);
12. Assignment (see §6.32);
13. Creditors' rights coverage (see §6.40-6.45); and
14. Post-policy or "gap" coverage (see §8.33I).

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§8.33C b. Exclusions

The 2006 ALTA loan policy contains seven exclusions, the same number as in the 1992 loan policy. However, the 2006 policy does not include Exclusion 6 of the 1992 policy, (regarding statutory liens for services, labor, or materials arising from an improvement or work related to the land that is contracted for and begun after the date of the policy, discussed in §6.47), but does include an exclusion not found in the 1992 policy (Exclusion 7, regarding liens for real estate taxes or assessments imposed by governmental authority during the "gap"). The exclusions in the 2006 loan policy are:

1. Police power laws, ordinances, permits, or regulations relating to building and zoning, subdivisions, and environmental protection or the effect of violation thereof (see §6.35-6.38);
2. Eminent domain (pending or prior) (see §6.39);
3. Bona fide purchaser status (see §§6.40-6.45);
4. Doing business laws (see §6.46);
5. Usury, consumer credit protection, and truth-in-lending laws (see §6.46);
6. Creditors' rights exclusion (see §§6.46-6.48); and
7. Taxes and special assessments in the "gap" (see §6.97).

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§8.33D c. Arbitration

The threshold below which either the insured or the insurer can require the other to submit to binding arbitration has been increased from $1,000,000 in the 1992 policy to $2,000,000 in the 2006 policy. In addition, the 2006 loan policy states that the arbitration is to be conducted pursuant to the ALTA Title Insurance Arbitration Rules, as opposed to those of the American Arbitration Association (AAA). Further, the 2006 loan policy makes clear that, except as provided in ALTA's Title Insurance Arbitration Rules, there can be no joinder or consolidation with claims or controversies of other persons. On arbitration procedures, see chap 14.

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§8.33E d. Proof of Loss

The 2006 loan policy eliminates the requirement that the insured claimant always provide a proof of loss. See §§12.16-12.23. Instead, the insurer must first attempt to determine the loss and, if it is unable to do so, may require the insured claimant to furnish a signed proof of loss. The remedy stated in the 1992 policy for failing to provide a proof of loss, terminating the insured claimant's rights, was removed. See §12.23. However, implicit in the 2006 policy is the right of the insurer to withhold payment under the policy until the insured claimant furnishes a signed proof of loss if requested to do so by the insurer. See App J, Condition 4.

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§8.33F e. Expanded Definition of "Insured"

The definition of "Insured" has been expanded. The definition adds as successors in ownership of the indebtedness, whether the successor owns the indebtedness for its own account or as a trustee or fiduciary. The term "Insured" has also been expanded to include the successor to an insured on conversion to a different kind of entity. Further, the term "Insured" now includes the grantee in a deed executed by the named insured and delivered for no consideration if the grantee (1) is wholly owned by the named insured, (2) wholly owns the named insured, or (3) is wholly owned by an affiliated entity of the named insured, provided the affiliated entity and the named insured are both wholly owned by the same person or entity. Finally, the definition of "Insured" also includes the person or entity who has "control" of the "transferable record," if the indebtedness is evidenced by a transferable record as defined by applicable electronic transaction law; this includes third parties, such as MERS (Mortgage Electronic Registration System) or other service providers, even though the third party may not be named when an electronic transaction is involved. See Com C §7106.

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Source: Real Property/California Title Insurance Practice/8 Lender's Policies and Endorsements/§8.33G f. New Definition of 'Indebtedness'

§8.33G f. New Definition of "Indebtedness"

The 2006 ALTA loan policy adds "Indebtedness" to its list of defined terms. "Indebtedness" is defined as the obligation secured by the insured mortgage. If the obligation is the payment of a debt, then "Indebtedness" includes:

- Principal disbursed as of the date of the policy;
- Principal disbursed subsequent to the date of the policy;
- Construction loan advances made subsequent to the date of the policy;
- Interest;
- Prepayment premiums, exit fees, and other similar fees and penalties permitted by law;
- Expenses of foreclosure and other costs of enforcement;
- Advances to assure compliance with law or to protect the priority of the insured mortgage prior to acquisition of title;
- Advances to pay taxes and insurance; and
- Reasonable amounts advanced to prevent deterioration of improvements to the land.

In measuring loss, these amounts will be reduced by the total of all payments received by the insured and by the amount forgiven by the insured. It would appear that the second and third items on this list are included solely for the purpose of measuring loss, because the 2006 loan policy does not insure the validity, enforceability, or priority of these subsequent advances unless they fall within the insuring provision of Covered Risk 11 or ALTA Endorsement Form 14.

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§8.33H g. Increase Regarding Extent of Liability

Condition 8(b)(i) of the 2006 ALTA loan policy provides for a 10-percent increase in the amount of insurance if the insurer pursues its rights to defend or prosecute an action to establish title and is unsuccessful. Condition 8(b)(ii) gives the insured the choice of having the loss or damage determined as of either the date the claim was made or the date it is settled and paid. These provisions are new to the 2006 policy.

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§8.33I h. Post-Policy or "Gap" Coverage

Covered Risk 14, post-policy or "gap coverage," applies only to title operations that issue final policies showing the date of the policy as the closing date. It does not apply if the final policy shows the date of the policy as the recording date. On date of policy, see §8.47; on priority of deed of trust, recordation, see §8.13. This provision is designed to protect the insured against loss arising from defects falling within Covered Risks 1 through 13 that are created, attach, or are recorded in the public records between the date of the policy and the recording date of the insured mortgage.

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Source: Real Property/California Title Insurance Practice/8 Lender's Policies and Endorsements/§8.33J 5. Comparison Chart for Covered Risks in Lender's Policies

§8.33J 5. Comparison Chart for Covered Risks in Lender's Policies

For ease of comparison, the risks covered by the CLTA policy and the 1992 and 2006 ALTA lender's policies are summarized below:

CLTA Policy	1992 ALTA Loan Policy	2006 ALTA Loan Policy
Title vested other than as stated in the policy (see §6.22)	Title vested other than as stated in the policy (see §6.22)	Title vested other than as stated in the policy (see §6.22)
Defects in title or liens or encumbrances on title (see §6.23)	Defects in title or liens or encumbrances on title (see §6.23)	Defects in title or liens or encumbrances on title (see §6.23)
Unmarketability of title (see §§6.24-6.26)	Unmarketability of title (see §§6.24-6.26)	Unmarketability of title (see §§6.24-6.26)
Lack of a right of access to and from the land (see §6.27)	Lack of a right of access to and from the land (see §6.27)	Lack of a right of access to and from the land (see §6.27)
		Enforcement of police powers laws, ordinances, permits and regulations relating to building and zoning, subdivisions, and environmental protection if notice of violation or intention to enforce is recorded in the public record (see §6.36)
		Enforcement of police powers other than those noted in Covered Risk 5 if notice of enforcement appears in the public records (see §6.37)
		Pending exercise of eminent domain power if notice of exercise is recorded in the public records (see §6.39)
		Prior taking by a

		governmental body that is binding on a bona fide purchaser for value and without notice (see §6.39)
		Creditors' rights coverage (see §6.48)
		Post-policy coverage (see §6.97)
FOR LENDERS ONLY: Invalidity or unenforceability of the lien of the insured mortgage on the title (see §6.28)	Invalidity or unenforceability of the lien of the insured mortgage on the title (see §6.28)	Invalidity or unenforceability of the lien of the insured mortgage on the title (see §6.28)
FOR LENDERS ONLY: Priority of any lien or encumbrance over the lien of the insured mortgage (see §6.29)	Priority of any lien or encumbrance over the lien of the insured mortgage (see §6.29)	Priority of any lien or encumbrance over the lien of the insured mortgage (see §6.29)
FOR LENDERS ONLY: Invalidity or unenforceability of any assignment of the insured mortgage (if the assignment is shown in Schedule B) or failure of the assignment to vest title to the mortgage in the insured assignee, free and clear of liens (see §6.32)	Invalidity or unenforceability of any assignment of the insured mortgage (if the assignment is shown in Schedule A) or failure of the assignment to vest title to the mortgage in the insured assignee, free and clear of liens (see §6.32)	Invalidity or unenforceability of any assignment of the insured mortgage (if the assignment is shown in Schedule A) or failure of the assignment to vest title to the mortgage in the insured assignee, free and clear of liens (see §6.32)
	Lack of priority of the lien of the insured mortgage over certain mechanics' liens (see §6.30)	Lack of priority of the lien of the insured mortgage over certain mechanics' liens (see §6.30)
	Any assessments for certain street improvements that gain priority over the lien of the insured mortgage (see §6.31)	Any assessments for certain street improvements that gain priority over the lien of the insured mortgage (see §6.31)

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Source: Real Property/California Title Insurance Practice/8 Lender's Policies and Endorsements/§8.33K 6. Comparison Chart for Exclusions in Lender's Policies

§8.33K 6. Comparison Chart for Exclusions in Lender's Policies

For comparison, exclusions in the CLTA and 1992 and 2006 ALTA lender's policies are summarized below:

CLTA Policy	1992 ALTA Loan Policy	2006 ALTA Loan Policy
1.(a) Any law, ordinance or governmental regulations (including but not limited to building or 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.	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.	1.(a) Any law, ordinance, permit, or governmental regulation (including those relating to building and zoning) restricting, regulating, prohibiting, or relating to: (i) the occupancy, use, or enjoyment of the Land; (ii) the character, dimensions, or location of any improvement erected on the Land; (iii) the subdivision of land; or (iv) environmental protection, or the effect of any violation of these laws, ordinances, or governmental regulations. This Exclusion 1(a) does not modify or limit the coverage provided under Covered Risk 5.
1.(b) Any governmental police power not excluded	1. (b) Any governmental police power not excluded	1.(b) Any governmental police power. This Exclusion

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.	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.	1(b) does not modify or limit the coverage provided under Covered Risk 6.
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 that has occurred prior to Date of Policy that would be binding on the rights of a purchaser for value without knowledge.	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 that would be binding on the rights of a purchaser for value without knowledge.	2. Rights of eminent domain. This Exclusion does not modify or limit the coverage provided under Covered Risk 7 or 8.
3. Defects, liens, encumbrances, adverse claims or other matters: (a) whether or not recorded in the public records at Date of Policy, but 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;	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 (except	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

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 insured mortgage or for the estate or interest insured by this policy.	to the extent that this policy insures the priority of the lien of the insured mortgage over any statutory lien for services, labor or material); or (e) resulting in loss or damage which would not have been sustained if the Insured Claimant had paid value for the insured mortgage.	(however, this does not modify or limit the coverage provided under Covered Risk 11, 13, or 14); or (e) resulting in loss or damage that would not have been sustained if the Insured Claimant had paid value for the Insured Mortgage.
4. Unenforceability of the lien of the insured mortgage because of the inability or failure of the insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with the applicable doing business laws of the state in which the land is situated.	4. Unenforceability of the lien of the insured mortgage because of the inability or failure of the insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with applicable doing business laws of the state in which the land is situated.	4. Unenforceability of the lien of the Insured Mortgage because of the inability or failure of an Insured to comply with applicable doing-business laws of the state where the Land is situated.
5. Invalidity or unenforceability of the lien of the insured mortgage, or claim thereof, which arises out of the transaction evidenced by the insured mortgage and is based upon usury or any consumer credit protection or truth-in-lending law.	5. Invalidity or unenforceability of the lien of the insured mortgage, or claim thereof, which arises out of the transaction evidenced by the insured mortgage and is based upon usury or any consumer credit protection or truth-in-lending law.	5. Invalidity or unenforceability in whole or in part of the lien of the Insured Mortgage that arises out of the transaction evidenced by the Insured Mortgage and is based upon usury or any consumer credit protection or truth-in-lending law.
	6. Any statutory lien for services, labor or materials (or the claim of priority of any statutory lien for services, labor or materials over the lien of the insured mortgage) arising from an improvement or work related to the land which is contracted for and commenced	

	subsequent to Date of Policy and is not 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.	
6. Any claim, which arises out of the transaction vesting in the insured the estate or interest insured by this policy or the transaction creating the interest of the insured lender, by reason of the operation of federal bankruptcy, state insolvency or similar creditors' rights laws.	7. Any claim, which arises out of the transaction creating the interest of the mortgagee 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 interest of the insured mortgagee being deemed a fraudulent conveyance or fraudulent transfer; or (b) the subordination of the interest of the insured mortgagee as a result of the application of the doctrine of equitable subordination; or (c) the transaction creating the interest of the insured mortgagee 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.	6. Any claim, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that the transaction creating the lien of the Insured Mortgage, is (a) a fraudulent conveyance or fraudulent transfer, or (b) a preferential transfer for any reason not stated in Covered Risk 13(b) of this policy.
		7. Any lien on the Title for real estate taxes or

		assessments imposed by governmental authority and created or attaching between Date of Policy and the date of recording of the Insured Mortgage in the Public Records. This Exclusion does not modify or limit the coverage provided under Covered Risk 11(b).

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§8.33L 6. ALTA Expanded Residential Loan Policy

The expanded residential coverage policy described in §7.49A is also available for lenders on one- to four-family residential property. Coverages added to the 1992 ALTA lender's policy may include:

- Coverage for future forgeries (*e.g.*, forgeries of an assignment or partial or full reconveyance of the insured deed of trust);
- Mechanics' lien coverage regardless of whether the work commences before or after the mortgage records and without regard to whether the work of improvement was financed in whole or in part by proceeds of the insured mortgage;
- Coverage for losses suffered when a restriction violation results in the inability to use the residential structure for residential purposes;
- Encroachments constructed after the date of policy by neighbors and without the consent of the owner of the property;
- Coverage when modified or replaced improvements constructed after the date of policy are damaged by others using the surface of the land in the course of extracting minerals;
- Affirmative coverage for matters affecting the title that would have been disclosed by an accurate survey; and
- Coverage for 125 percent of the stated insurance amount effective immediately upon issuance of the policy. (Useful for negatively amortized loans and for defaults in connection with a total failure of title if the accruing interest causes the balance due to exceed the original amount of the loan. Examples of a total failure of title are a forgery on the deed of trust or a forgery of the deed to the purported current owner of the property who executed the deed of trust.)

The following endorsements may be automatically included in the expanded residential lender's policy:

- Usury (§§8.117-8.118);
- CLTA 100.2/ALTA 9 (§§8.51-8.57);
- CLTA 100.29 (§§8.85-8.86);
- CLTA 110.9/ALTA 8.1 (§§8.77-8.78);
- CLTA 111.5/ALTA 6 (§§8.99-8.100);
- CLTA 111.8/ALTA 6.2 (§§8.99-8.100);
- CLTA 116 (§§8.93-8.94) (note, however, that this coverage is limited to "location and dimensions" and does not include assurances of the accuracy of any acreage stated on the map, *Golden Sec. Thrift & Loan Ass'n v First Am. Title Ins. Co.* (1997) 53 CA4th 250, 61 CR2d 442);
- CLTA 116.7 (§§7.94-7.96, 8.93-8.94); and
- CLTA 123.1/ALTA 3 (§§7.97-7.99, 8.101).

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D. ALTA Construction Loan Policies

§8.34 1. 1992 ALTA Construction Loan Policy

The 1992 construction loan policy is rarely used in California. Instead of insuring mechanics' lien claims in the insuring provisions of the policy, as the ALTA lender's policy does, the ALTA construction loan policy requires use of endorsement forms "A" and "B," which condition coverage on the lender's compliance with the disbursement requirements of the construction loan agreement.

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§8.35 a. Form A Endorsement

The form A endorsement insures the lender against mechanics' lien priority claims if the lender advances funds for labor or materials provided to a job site before recordation of the insured construction deed of trust. Before each insured advance, the title insurer may require an investigation into the work performed and payment for labor or materials supplied.

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§8.36 b. Form B Endorsement

The form B endorsement is used if no visible work has begun on the recording date of the construction deed of trust. It insures the priority of future obligatory advances made under the construction loan agreement.

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§8.37 c. Exclusions From Endorsements

The insurance provided by the form A and B endorsements is not subject to the following exclusions:

- Defects attaching after the date of the policy (exclusion 3(d));
- Unrecorded mechanics' liens (exclusion 6); and
- The lack of priority of the insured deed of trust because of failure to fully disburse loan proceeds (exclusion 7).

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§8.38 2. Package Construction Loan Policies

Many title insurance companies issue loan policy products in a package (often called an "LP-10" or similar designation) that insure the construction lender under an ALTA lender's policy and insure the permanent lender with an ALTA lender's policy after completion of construction of the improvements. Many lenders who ask for this package also require insurance against encroachments of foundations and other CLTA endorsements to insure priority of disbursement made during construction and after the filing of the notice of completion. See §§8.79-8.80. (The "LP-10" usually designates an ALTA lender's policy, while "LP-9" usually refers to a CLTA policy.)

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§8.39 E. 1992 ALTA Leasehold Loan Policy Withdrawn and Replaced by Endorsement 13.1

ALTA formerly offered a separate ALTA leasehold lender's policy if the loan was secured by a leasehold estate. The leasehold estate and its terms were described in paragraphs 2-3 of Schedule A and Condition 1(h) of the policy. Conditions 7-14 provided how loss was measured under the ALTA leasehold loan policy. See also §7.57.

In 2001, however, ALTA withdrew the leasehold loan policy and adopted ALTA Endorsement 13.1, to be used with an ALTA lender's policy. On the terms of the current version, Endorsement 13.1-06, see §6.14.

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§8.40 F. Limited Coverage Policies

In some instances (*e.g.,* home equity loans secured by second deeds of trust on a borrower's home), the lender wants some assurances regarding title but, because of cost and risk factors, does not want to obtain a standard or extended coverage policy. To fill this need, title insurance companies offer limited coverage policies. For discussion of these policies, see §§9.22-9.23.

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§8.41 III. LENDER'S CONCERNS

Lenders should be aware of when losses under their title policies will arise and how these losses will be measured. As explained in §§8.42-8.45, in these respects the lender's coverage differs significantly from the owner's coverage. Lenders must also understand that the policy amount may decline in certain circumstances. These concerns are related to the repayment of the lender's debt. If a lender forecloses on its security, or obtains title by other means, it should also evaluate whether to obtain owner's coverage.

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A. Measure and Timing of Loss

§8.42 1. Measure of Loss

The measure of loss under an ALTA lender's policy is fundamentally different from that under an owner's policy. See §6.74. Under Condition 7 of the 1992 and 2006 ALTA lender's policies, the monetary liability of the title insurer is the *lesser* of the following:

- The face amount of the policy or, if the insured lender has acquired title through foreclosure, the unpaid balance of the debt, unpaid interest, foreclosure expenses, and amounts advanced to protect the lien and the property before foreclosure;
- The amount of the unpaid principal indebtedness plus obligatory and protective advances, reduced by any payments (except for defense and litigation expenses) made for claims under the policy (but if the insured lender acquires title to the secured real property, no such reduction shall occur unless such payments also reduce the amount of the secured indebtedness) at the time the loss or damage occurs, together with interest on the principal; or
- The difference between the value of the insured estate or interest and the value of the insured estate or interest subject to the defect insured against by the policy.

It is important to note that the amount of the insurance is also subject to reduction on payments of the indebtedness under Condition 9(b), but it may be increased once again by accruing interest and protective advances, which are not to exceed the stated amount of insurance.

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§8.43 2. Timing of Loss

Unlike an owner under an owner's title insurance policy, a lender cannot demonstrate loss simply by showing that the defect insured against by the policy has reduced the value of the insured property. Rather, the lender must demonstrate that the indebtedness secured by the lien has not been repaid because of the defect in the property title insured. The courts have held that such a loss cannot be shown until after:

- Completion of the foreclosure sale and determination of fair market value and amount of senior liens at the time of the foreclosure sale (*Karl v Commonwealth Land Title Ins. Co.* (1993) 20 CA4th 972, 24 CR2d 912 (*Karl I*); *Karl v Commonwealth Land Title Ins. Co.* (1997) 60 CA4th 858, 871, 70 CR2d 374 (*Karl II*)), or
- The lender fails to recoup the portion of its debt that is insured following the sale of the property by the insured lender to a third party after the lender acquires the property at the foreclosure sale (*Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 275 CR 107).

Until such a loss occurs, there is no duty to indemnify the insured for its loss. *Cale v Transamerica Title Ins. Co., supra*. See §§11.12-11.14 on the split of authority about when the loss occurs. Although the lender's coverage continues on its acquisition of title, the more limited recovery available under an ALTA lender's policy is why many lenders obtain an owner's policy on acquisition of title. See §§7.4, 8.48-8.49.

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Source: Real Property/California Title Insurance Practice/8 Lender's Policies and Endorsements/§8.44 a. Analysis of Timing of Loss in Karl v Commonwealth Land Title Ins. Co.

§8.44 a. Analysis of Timing of Loss in *Karl v Commonwealth Land Title Ins. Co.*

The principles that apply to a claim by an insured lender that has foreclosed on a deed of trust junior to encumbrances not listed as exceptions on the title policy were analyzed by the court in *Karl v Commonwealth Land Title Ins. Co.* (1993) 20 CA4th 972, 978, 24 CR2d 912 (*Karl I*). The lender was repaid in full but, on a subsequent sale of the property, lost a potential recovery greater than repayment of the secured indebtedness because of the existence of the senior encumbrances. The court noted the holdings of *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 275 CR 107, and *Lawrence v Chicago Title Ins. Co.* (1987) 192 CA3d 70, 237 CR 264, and sought to harmonize its conclusion with the decisions reached in those cases. In summary, the court reached the following conclusions:

- A title insurance policy is an indemnity contract, not a guaranty.
- The policy covers only actual losses, not lost profits.
- When a secured lender obtains full repayment of the secured debt (which is all that is insured), it ordinarily sustains no loss that is compensable under the policy.
- An insured lender that forecloses on its security sustains a loss on the date of the foreclosure sale if the value of the property received at the foreclosure is less than the secured debt because of a title defect that is not excepted from coverage.
- Typically, the earliest that a loss can be claimed on a lender's policy is at the time of completion of a foreclosure sale (and not the ultimate resale of the property as in *Cale*).
- The fair market value of the property at the time of the foreclosure sale must be less than the total of the lender's lien plus all prior liens (*i.e.*, it must be insufficient to satisfy the lender's lien).
- The fair market value of the property exclusive of all liens must be more than the amount of the disclosed senior liens (*i.e.,* it must be sufficiently large so that the lender might have recovered after the disclosed senior liens were satisfied).
- The fair market value of the property is not discounted to reflect costs that must be incurred to sell the property. *Karl v Commonwealth Land Title Ins. Co.* (1997) 60 CA4th 858, 871, 70 CR2d 374 (*Karl II*).
- The amount for which the property is later resold may be relevant in calculating the property value at the date of the foreclosure sale by making appropriate adjustments.

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§8.45 b. Benefit to Lender of *Karl v Commonwealth Land Title Ins. Co.*

The principal benefit to the insured lender of the decision in *Karl v Commonwealth Land Title Ins. Co.* (1993) 20 CA4th 972, 24 CR2d 912 (*Karl I*), is that an acquiring lender need not resell the property before it makes a claim on its title insurance policy and need not wait until resale as required by *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 275 CR 107. On the making of claims by lenders, see §6.72. On making claims generally, see chap 12.

Despite the holding in *Karl I,* the lender should still put the title insurance company on notice of potential claims as soon as it is aware of any such claims and also consider the value of any claim when making a credit bid at foreclosure.

PRACTICE TIP: If several parcels of property are used as security for the same deed of trust, lender's counsel should consider obtaining a first loss payable endorsement that modifies the timing of the loss for the lender. See §§8.106-8.107.

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§8.46 B. Reduction of Coverage

Condition 9 of the 1992 ALTA lender's policy and Condition 10 of the 2006 ALTA lender's policy set forth both the manner in which the amount of lender's insurance is reduced over time and the conditions for termination of liability under the lender's policy. Condition 9(a) of the 1992 policy and Condition 10(a) of the 2006 policy provide that all payments made under the policy will reduce the insurance in a like amount, except for payments that are made before acquisition of title by the insured, to the extent that such payments do not reduce the amount of the indebtedness secured by the insured deed of trust. See §6.78.

Under Condition 9(b) of the 1992 lender's policy, as the indebtedness is repaid, the policy amount is reduced by the amount of the payment, subject to increases for accruing interest and protective advances, up to the stated policy amount. See §8.42. However, the 2006 ALTA lender's policy deletes this condition, and thus, a payment on the mortgage under the 2006 policy does not reduce the amount of insurance available. Thus, the insured need not request a "last-dollar" endorsement when using the 2006 policy. On "last-dollar" endorsements, see §8.108.

Under Condition 9(c) of the 1992 ALTA lender's policy and Condition 10(b) of the 2006 policy, payment in full or the voluntary satisfaction or release of the insured deed of trust terminates all liability of the insurer.

PRACTICE TIP: Lenders who are concerned that any portion of their debt may not be covered under the amount of insurance stated in the policy should consider increasing that amount by endorsement. For example, a lender insured by an ALTA lender's policy who makes an additional optional advance, which is neither contemplated at the time of the closing of the loan nor insured, should request a CLTA 108.8 endorsement to cover the additional advance when made. On endorsements for advances, see §§8.61-8.62.

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§8.47 C. Date of Policy

The date of the policy, set forth in Schedule A of the ALTA lender's policy, is typically the date of recordation of the insured deed of trust. Covered Risk 14 in the 2006 ALTA lender's policy provides post-policy or "gap coverage" to protect the insured against loss arising from defects falling within Covered Risks 1 through 13 that are created, attach, or are recorded in the public records between the date of the policy and the recording date of the insured mortgage.

Some out-of-state lenders are accustomed to receiving title insurance dated as of the date of delivery of funds to the title or escrow company, which may be before the date of recordation of the deed of trust. Some California title insurance companies provide a temporary policy that applies to the gap period between funding and recordation of the deed of trust, but many other companies will be concerned with what essentially amounts to insuring an unrecorded interest. If the insurer agrees to provide a temporary policy, it may request an indemnification from the borrower.

NOTE: This request for a temporary policy for the gap period reflects a fundamental misunderstanding of California escrow closings. In a typical California loan transaction, funds are not delivered to the borrower until the deed of trust is recorded, so title insurance should not be needed until that time.

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D. Insuring Lenders on Foreclosure or Deeds in Lieu of Foreclosure

§8.48 1. Acquiring Owner's Policy

One issue confronting lenders that acquire title to encumbered property is whether additional title insurance should be obtained at the transfer. An ALTA lender's policy protects beneficiaries who acquire title by foreclosure or deeds in lieu of foreclosure. See §6.64. However, this coverage relates back to the date of the policy, not to the date of transfer, and would therefore not cover the transfer itself (unless a claim relates to matters covered, *e.g.,* priority of the deed of trust). In addition, the measure of damages in a lender's policy is more limited than in an owner's policy. See §§6.67, 8.42-8.45. Thus, many lenders obtain a new owner's policy as of the date of the foreclosure sale or of recordation of a deed given in lieu of foreclosure. See §§6.65-6.66.

Alternatively, if a lender intends to resell the property to a third party, which would require a new owner's policy, it is often advisable from a cost standpoint to obtain a binder for such coverage. A binder allows the lender to have a policy issued at any time within the period specified in the policy (usually two years), either to itself (if a claim arises) or to a third party purchaser, at a rate less than the premiums charged for two separate policies. On binders, see §§3.20-3.25.

PRACTICE TIP: When a lender plans to obtain owner's coverage at foreclosure or on receipt of a deed in lieu of foreclosure, lender's counsel may want to obtain and review a pro forma policy before the sale or transfer in order to help evaluate the state of title at the foreclosure or on receipt of a deed in lieu of foreclosure. See §10.11. The lender or lender's counsel may also want to consult with the title insurer for the best pricing package. Lender's counsel should request that the policy or binder be issued without a creditor's rights exception, but counsel will have to address any concerns that the title insurer may have, as discussed in §8.32. At a minimum, a lender should negotiate the removal of the creditor's rights exclusion from its binder for the issuance of a policy to a later bona fide third party purchaser.

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§8.49 2. Obtaining Nonmerger Endorsement

In a transfer using a deed in lieu of foreclosure, lenders often elect to maintain their deed of trust of record, in the event the transfer is set aside. If this occurs, a CLTA 107.11 nonmerger endorsement should be obtained on the lender's existing loan policy. This endorsement insures against losses sustained because of the invalidity or unenforceability of the lien of the insured deed of trust caused by the fee estate's being vested in the insured lender. Some insurers will agree to modify this endorsement to insure against losses of priority as a result of such transfers. Other insurers will seek to limit their exposure by providing in the endorsement that the insured may recover from the insurer only after it has obtained a final judgment.

Most insurers insist on the inclusion of nonmerger language in the insured's deed of trust, as well as in the note it secures. Some insurers, however, accept nonmerger language in the deed given in lieu of foreclosure, if it was not included in the other documents, in order to satisfy this requirement. On deeds in lieu of foreclosure, see California Mortgages, Deeds of Trust, and Foreclosure Litigation §§7.2-7.21 (4th ed Cal CEB 2009).

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Source: Real Property/California Title Insurance Practice/8 Lender's Policies and Endorsements/§8.50 IV. ENDORSEMENTS

§8.50 IV. ENDORSEMENTS

An endorsement to a title insurance policy modifies the policy. It may alter, enlarge, or reduce coverage. The endorsement's language, if not ambiguous, will prevail over the more general language in the body of the policy. *McFarland v New Zealand Ins. Co*. (1959) 176 CA2d 422, 424, 1 CR 482. Most standard endorsements increase the coverage provided in the basic policy. The California Land Title Association (CLTA) has adopted over 100 standard endorsements. In California, these endorsements are used most often with both CLTA and ALTA policies. For a list of CLTA endorsements, see App N. The American Land Title Association (ALTA) has also adopted standard endorsements, which are seldom used in California and are usually requested by out-of-state lenders. See §§7.99, 8.102. Each title insurance company also issues its own endorsements, which if frequently requested, will be named, numbered, or both. See §§7.100-7.103, 8.103-8.118. Rare or unique endorsements will be negotiated by the title insurance company and the proposed insured.

Effective January 1, 1997, the CLTA modified virtually all its numbered endorsements that use the word "assurance." That word has been deleted and replaced with "insurance." The CLTA's purpose in making this change is to clarify that these endorsements are intended to provide only additional insurance. By issuing assurances, title insurance companies did not intend to assume any liability beyond indemnity coverage.

Lenders usually request endorsements to provide affirmative insurance against matters otherwise excluded or excepted from coverage. Before issuing an endorsement, the title insurance company will evaluate the risk. Underwriting practices may require inspections, reviews of survey matters, or statements from the lender to validate issuance of the endorsement.

PRACTICE TIP: If a given title insurance company is unwilling to provide the coverage, counsel should contact other title insurance companies to see whether the coverage is available elsewhere.

Many lender endorsements are requested after issuance of the policy and usually require a new title search.

An important factor to evaluate when analyzing which endorsements are needed is the cost of the endorsement. Some are free, and others cost as much as 25 percent of the premium. Competition among title insurance companies keeps the costs for each endorsement fairly comparable.

NOTE: Some title insurance companies offer a CD-ROM containing the standard form title policies, the CLTA and ALTA endorsements, and the title insurance company's numbered endorsements. Some also contain underwriting guidelines.

Sections 8.51-8.101 begin with a discussion of the CLTA 100 endorsement, which is customarily issued to an insured under an ALTA lender's policy, and then proceed alphabetically to discuss the CLTA endorsements most frequently requested by lenders.

CAVEAT: Some CLTA endorsements contain the following limitation:

> It is also important to note that the loss or damage covered must be sustained by reason of the entry of a final court order or judgment determining or judging the matter insured against.
>
> The insured should take special note of this limitation because it limits the coverage of the endorsement to indemnity coverage only. Defense costs are *not* covered.

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§8.51 A. CLTA 100 Endorsement

Most institutional lenders in California require the CLTA 100 endorsement. It provides a variety of additional coverages for record and off-record title issues. It is issued only in conjunction with an ALTA lender's policy. The key to the issuance of the endorsement on a routine basis, without cost, are the facts that the likelihood of any loss suffered by a lender is remote and that a lender's loss is measured differently from an owner's loss. See §§8.42-8.45. For example, following a foreclosure, an encroachment that results in the removal of portions of lawn or shrubbery should not jeopardize the value of the lender's security. The CLTA 100 endorsement is restricted to the stated policy coverage limits in Schedule A. For a further discussion of the CLTA 100 endorsement, see §§7.80-7.83.

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§8.52 1. Terms of Endorsement

The first two parts of the CLTA 100 endorsement provide the lender with coverage for a loss if any of the following are *not* true:

- There are no covenants, conditions, or restrictions (CC&Rs) that can cut off, subordinate, or impair the insured deed of trust;
- There are no present violations of enforceable CC&Rs;
- There are no encroachments of improvements onto adjoining lands or onto the insured land by adjoining improvements, except as shown in Schedule B;
- Any future violations of the CC&Rs will impair neither the lien of the insured deed of trust nor title if the insured acquires title to the land secured by a deed of trust; or
- Any violation of the CC&Rs before acquisition of title by the insured will not render title unmarketable.

The third part of the CLTA 100 endorsement insures against a loss arising from damage to existing improvements, including defined landscape plantings, that:

- Encroach onto an easement shown in Schedule B, resulting from use or maintenance of the easement right; or
- Result from the use of the land's surface to extract or develop minerals that are either excepted from the policy description or are shown in a Schedule B reservation.

The fourth part of the CLTA 100 endorsement insures against loss arising from a final court order or judgment requiring removal of an encroachment shown in a Schedule B exception.

If an ALTA leasehold policy is issued, the CC&Rs shown in a Schedule A lease document are expressly excluded from this endorsement.

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§8.53 2. Underwriting Criteria

Generally, underwriters do not require a survey or an inspection to issue the CLTA 100 endorsement. The specific issues the underwriter may look for in providing this coverage are summarized briefly in §§8.54-8.57. In practice, an underwriter generally reviews some or all of the factors only if it is aware of a specific problem. This endorsement is issued free of charge.

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Source: Real Property/California Title Insurance Practice/8 Lender's Policies and Endorsements/§8.54 a. Covenants, Conditions, and Restrictions (CC&Rs)

§8.54 a. Covenants, Conditions, and Restrictions (CC&Rs)

If CC&Rs are recorded, the title insurance company may review them to learn:

- Whether they are still in effect;
- Whether they contain any rights of reversion; or
- Whether they contain an express savings clause to protect the priority of deeds of trust from foreclosure of any assessment liens.

The title insurance company may also inquire about any current violations of the CC&Rs or pending endorsement actions. On CC&Rs generally, see Forming California Common Interest Developments, chap 7 (Cal CEB 2004).

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§8.55 b. Easements

With respect to coverage for easements, the title insurance company may review the easement to ascertain:

- What the purpose of the easement is;
- Whether it is a fixed easement;
- What effect the easement may have on improvements if the rights granted in the easement are exercised;
- What damage might result from maintenance of the easement; and
- Whether the easement would interfere with the use of the property.

On easements generally, see California Real Property Sales Transactions, chap 11 (4th ed Cal CEB 2007).

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§8.56 c. Mineral Rights and Surface Entry

The title insurance company may review any reservation or exception of mineral rights for a waiver of surface entry.

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§8.57 d. Encroachments

The title insurance company may attempt to ascertain the scope of an encroachment and evaluate the risks involved, including the likelihood that someone may demand the removal of encroaching improvements and the probable result of such a demand (including the possibility of litigation and the cost of removal). If the company knows of an encroachment, underwriting practices may dictate modifying the CLTA 100 endorsement to eliminate encroachment coverage provisions and adding the encroachment to Schedule B as an exception.

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§8.58 3. Variations of CLTA 100 Endorsement

The CLTA provides several variations of the CLTA 100 endorsement for issuance in different situations. For example, minor variations can be found in the CLTA 100.1 endorsement, which conforms the language of the 100 endorsement for use with a CLTA policy. The CLTA 100.2 endorsement (identical to the ALTA Form 9) is intended for use nationally. Many of the variations on the 100 endorsement must be approved by underwriting counsel after review and determination of coverage issues. The general underwriting criteria for the endorsements are the same as for the CLTA 100 endorsement. For a further discussion of CLTA 100 endorsements, see §§7.80-7.83.

The CLTA 116 endorsement is usually issued as a companion to the CLTA 100 endorsement. See §§8.93-8.94.

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B. Access

§8.59 1. CLTA 103.4 and 103.7 Endorsements

As with certain shopping center developers, many lenders want insurance that the property has access through a described easement to and from a specified public street (CLTA 103.4 endorsement) or abuts a physically open street (CLTA 103.7 endorsement). Both endorsements are issued in conjunction with the CLTA policy and the ALTA lender's policy. See §§7.72-7.73.

For a lender, an insuring clause of both the CLTA policy and the ALTA lender's policy covers access. These endorsements are still important when the lender wants additional comfort, such as insurance that the property physically abuts the public street.

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§8.60 2. Underwriting Criteria

In addition to a review of the record title, such as deeds of easement, the underwriter may require a survey and an inspection before issuing either a CLTA 103.4 or 103.7 endorsement. Before it will issue the former, the underwriter must confirm that there is an insurable easement that provides a means of ingress and egress to and from the insured land to a public street. Before it will issue the latter, the underwriter must confirm that the street named in the endorsement is physically open, that it abuts the insured land, and that nothing prohibits access from the land to the street.

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C. Advances

§8.61 1. CLTA 108.7, 108.8, 111.10, 111.11 and Series 122 Endorsements

Several endorsements insure the priority of the lender's lien if either optional or obligatory advances are made under an insured deed of trust. The CLTA 108.7 endorsement, issued in conjunction with a CLTA policy, and the CLTA 108.8 endorsement, issued in conjunction with an ALTA lender's policy, insure optional advances. They ensure that:

- The maker of the note holds title to the insured property;
- The advance has not resulted in the loss of priority of the deed of trust; and
- No reconveyance, modification, or subordination of the deed of trust has occurred.

If the deed of trust secures a revolving credit line, the lender can obtain comparable coverage through the CLTA 111.10 endorsement for optional advances or through the CLTA 111.11 endorsement for obligatory advances. Both endorsements are available for lenders under either a CLTA policy or an ALTA lender's policy, and both provide coverage for changes in the interest rate.

Obligatory advances (primarily construction loan advances) are usually insured under the CLTA series 122 endorsements. The CLTA 122 and 122.2 endorsements are designed to be issued with an ALTA extended coverage lender's policy. The 122.3 and 122.4 endorsements are intended for use with the ALTA construction loan policy and are seldom used in California.

PRACTICE TIP: An advance not required under or made in violation of the terms of the applicable loan agreement will not be covered by a CLTA 122 endorsement. In these circumstances, a CLTA 108.8 endorsement should be obtained.

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§8.62 2. Underwriting Criteria

For the CLTA 108.7 endorsement, title insurance companies require:

- A representation from the lender regarding the optional advance and confirmation that the deed of trust contains the appropriate future advance provision; and
- A record title search of the matters insured in the endorsement.

Before issuing a CLTA 108.8 endorsement, the title insurance company may also require an inspection. If the deed of trust does not contain the appropriate future advance provision, the title insurance company will require that a modification, with this provision, be recorded.

Obtaining the CLTA 111.10 or 111.11 endorsement generally requires a review of the deed of trust to confirm that it discloses that the secured loan is a revolving credit loan. Both endorsements also require a review of the loan agreement to confirm that it contains the appropriate advance language.

Before issuing a CLTA 122 or 122.2 endorsement, the title insurance company may require either a statement from the lender, providing particulars of the advance, or a copy of the note or loan agreement. The company will also conduct a complete record search from the date of the policy or from the last endorsement.

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D. Assignment of Beneficial Interest in Deed of Trust

§8.63 1. CLTA Series 104 (ALTA Forms 10 and 10.1) Endorsements

Several of the CLTA series 104 endorsements are designed to insure the assignee of an insured deed of trust. The CLTA 104 endorsement, issued in conjunction with an ALTA lender's policy, insures that:

- The beneficial interest in the deed of trust instrument has been transferred by valid assignment;
- There are no subsisting tax or assessment liens prior to the deed of trust except as shown in the policy;
- There are no matters affecting the validity or priority of the deed of trust except as shown in the policy; and
- There are no federal tax liens or bankruptcy proceedings shown by the public records except as shown in the policy.

This endorsement does not provide coverage for the enumerated exceptions discovered as of the date of issuance.

The CLTA 104.1 endorsement is used with the CLTA policy and provides more limited coverage for assignees. It insures that:

- A valid transfer of the beneficial interest to the assignee has occurred; and
- No reconveyance, subordination, or modification to the deed of trust has occurred.

If the parties intend to make a collateral assignment, the CLTA 104.4 and 104.11 endorsements are designed to ensure the collateral assignee that the beneficial interest has been assigned as collateral security. Unlike other CLTA 104 endorsements, which are based on the face amount of the policy, these endorsements insure in the amount of the collateral loan. Both are available for the CLTA policy and the ALTA lender's policy.

When multiple assignees exist, the CLTA 104.8-104.11 (ALTA Forms 10, 10.1) endorsements are used. These endorsements expressly exclude a title loss resulting from the insured assignee's failure to have possession of the note or a proper note endorsement. This coverage is important because failure to possess the note may result in a questionable assignment. See *In re Staff Mortgage* (9th Cir 1980) 625 F2d 281. See also CC §3440, which provides that, without a physical transfer of the note, the sale may be invalidated as a fraudulent conveyance.

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§8.64 2. Underwriting Criteria

In issuing the CLTA 104 and 104A endorsements, underwriters may:

- Examine the note to confirm that it is properly endorsed to the current assignee;
- Confirm that the form of the assignment is absolute, not collateral;
- Check real property taxes, bonds, assessments, and recorded tax liens;
- Check for any bankruptcy notices against the assignor and original and successor trustors under the deed of trust;
- Confirm that all assignments are recorded; and
- Review title records to learn whether any intervening assignments, reconveyances, modifications, or subordinations of the deed of trust have occurred.

Before issuing the CLTA 104.4 or 104.11 endorsements, the underwriter may:

- Confirm that the note is properly endorsed;
- Review title records to learn whether any intervening assignments, reconveyances, modifications, or subordinations of the deed of trust have occurred;
- Verify the amount of the collateral loan; and
- Record all assignments.

The underwriter may rely on information provided by the lender or an independent escrow company in confirming specifics regarding the promissory note, its possession, and its endorsement. If the title insurance company has not seen the original promissory note, it must decide whether to rely on representations provided by the independent escrow company or the lender or to require that the note be produced in escrow.

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E. Assignment of Rents

§8.65 1. CLTA 104.6 and 104.7 Endorsements

The CLTA 104.6 endorsement, which is available with the ALTA lender's policy, ensures the lender that a separate document, usually called an "assignment of rents," has been properly executed and that there are no prior recorded assignments of the lessor's lease interest except as shown in Schedule B.

The CLTA 104.7 endorsement, which is available with all lender's policies, also provides affirmative insurance against loss that the insured sustains by the existence, as shown by the public records, of any assignment of rents (prior to the assignment of rents in the insured deed of trust) other than any assignment of rents in the exceptions to coverage in Schedule B.

PRACTICE TIP: Because many lenders include an assignment of rents both in the deed of trust and in a separate document assigning leases and rents, both the CLTA 104.6 and 104.7 endorsements may be issued in connection with a loan transaction.

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§8.66 2. Underwriting Criteria

The title insurance company will search title to confirm that there are no prior assignments and will confirm the priority of the assignment of rents and whether it is in a separate document or in the secured deed of trust.

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§8.67 F. Coinsurance (CLTA 114 and 114.1 Endorsements)

Many lenders have internal guidelines dictating how much coverage the lead insurer can assume. The CLTA 114 and 114.1 endorsements provide for coinsurance between two or more companies. These endorsements create equal or joint and several liability or establish another order of liability between the coinsurers.

On coinsurance endorsements, see §§7.76-7.77; on coinsurance generally, see §§3.11-3.14; on reinsurance (which does not require an endorsement), see §§3.8-3.10.

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G. Condominiums and Planned Unit Developments

§8.68 1. CLTA 115, 115.1 (ALTA Form 4), 115.2 (ALTA Form 5), and 116.2 Endorsements

The CLTA 115 endorsement ensures the lender, with either a CLTA policy or an ALTA lender's policy, that the insured property is a condominium under CC §783 and is entitled to be taxed as a separate parcel. The CLTA 115.1 endorsement (identical to the ALTA Form 4) extends that coverage for an ALTA lender's policy to matters such as:

- The effectiveness of the documents creating the condominium;
- The absence of present violations of condominium restrictions;
- The priority of the deed of trust lien over condominium assessment liens; and
- The absence of encroachments of improvements into the common area or another unit.

The CLTA 115.2 endorsement (identical to the ALTA Form 5) provides coverage similar to the CLTA 115.1 endorsement for a planned unit development. The CLTA 116.2 endorsement ensures the lender (under either a CLTA policy or an ALTA lender's policy) of the accuracy of the street address and map references. See §§7.94-7.96, 8.93-8.94.

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Source: Real Property/California Title Insurance Practice/8 Lender's Policies and Endorsements/§8.69 2. Underwriting Criteria

§8.69 2. Underwriting Criteria

The underwriter will confirm that the condominium is a fee estate and is separately assessed for tax purposes before issuing the CLTA 115 endorsement. Before issuing the CLTA 115.1 or 115.2 endorsements, the underwriter may:

- Review the applicable condominium documents;
- Confirm that there is no reversion clause in any restrictive covenants;
- Confirm that the assessment liens are subordinate to the insured deed of trust;
- In the absence of a clearly separate tax parcel number for the unit, obtain a representation from the assessor that the unit and any common elements are assessed as one separate parcel;
- Confirm that no encroachment problems exist; and
- If required because of any outstanding issues on assessments or other matters that may affect the unit, obtain affidavits from the seller or the association clarifying those issues.

The CLTA 116.2 endorsement may require a review of the plat map to confirm the accuracy of the description.

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§8.70 H. Contiguity (CLTA 116.4 Endorsement)

If the insured property includes two separate but adjoining lots, the lender may require a CLTA 116.4 contiguity endorsement, which insures against losses resulting from any gap, strip, or gore between the two lots. For discussion of the contiguity endorsement, see §§7.78-7.79.

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I. Covenants, Conditions, and Restrictions (CC&Rs)

§8.71 1. CLTA Series 100 Endorsements and CLTA 124.1 Endorsement

The CLTA series 100 endorsements attempt to meet a lender's concerns that a potential violation of recorded CC&Rs may affect the priority or impede the enforceability of the deed of trust. The series 100 endorsements focus on CC&Rs that burden the insured estate. To meet special underwriting requests, in addition to the CLTA 100 endorsement (see §§8.51-8.57), specialized forms insure against a loss created by:

- An exercise of a right of reverter in a restriction or a covenant (CLTA 100.12 and 100.18 endorsements);
- The priority of assessment liens created by a declaration of restrictions (CLTA 100.13 endorsement);
- Any modification of the CC&Rs (CLTA 100.17 endorsement);
- Any attempted enforcement of the CC&Rs as to an existing violation of the CC&Rs (CLTA 100.20 endorsement); and
- Failure of construction plans to be approved as required by the CC&Rs (CLTA 100.21 endorsement).

The CLTA series 124 endorsements focus on the enforceability of CC&Rs that benefit the insured estate. The CLTA 124.1 endorsement ensures the insured that both affirmative and negative covenants recorded by a covenantor and covenantee are binding (except as to specific parties who may acquire through bankruptcy or specific tax lien acquisitions). Except for the CLTA 100.13 endorsement, which is issued only with an ALTA lender's policy, these endorsements may be issued with either an ALTA lender's policy or a CLTA policy.

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§8.72 2. Underwriting Criteria

Before issuing the CLTA 100.12 or 100.18 endorsement, the underwriter will want to confirm that *one* of the following is correct:

- There is no reverter or use of the word "conditions" in any covenant;
- The holder of the reversion has expressly waived all reversion rights;
- An implied waiver of the reversion has occurred through allowing other violations in the neighborhood; or
- The holder of the reverter has conveyed all lots in the tract under a general plan of development.

The CLTA 100.13 endorsement may be issued on confirmation that:

- The CC&Rs were recorded after the insured deed of trust;
- Priority is established as of the date the lien is filed, and no lien has been filed; or
- The CC&Rs' provisions make them subordinate to the insured deed of trust.

The underwriter may review the modification to the CC&Rs to confirm that it was executed by all necessary parties before it will issue a CLTA 100.17 endorsement. The company may also evaluate the likelihood that a court will enforce, or a party will attempt to enforce, the CC&Rs with respect to any violation before it will issue the CLTA 100.20 endorsement. The underwriter also usually reviews the plans and the approval of plans by the association or its designated committee before it will issue a CLTA 100.21 endorsement.

The CLTA 124.1 endorsement may be issued after the underwriter:

- Confirms that the requirements of CC §1468 have been met;
- Confirms that the agreement or deed is recorded;
- Limits coverage to the public records;
- Reviews the CC&Rs to confirm that they adequately describe the property, are binding on and enforceable by successors, are recorded, and contain a severability provision if any other provision proves to be unenforceable; and
- Conducts a public records search of the burdened property.

NOTE: The CLTA series 124 endorsements tend to be expensive.

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J. Elimination of Exceptions

§8.73 1. CLTA 110.1 Endorsement

The CLTA 110.1 endorsement is used to delete a preprinted exception. It can also be used after a policy is issued to delete a typewritten exception that has been reconveyed of record.

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§8.74 2. Underwriting Criteria

The underwriting criteria for issuance of this endorsement depends on which exception is being deleted from the policy. The underwriter might require an indemnity if the matter insured against by this endorsement is within the insured's control. See §§7.84-7.85.

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K. Encroachments

§8.75 1. CLTA 103.1, 103.3, 103.6, and 103.9 Endorsements

The CLTA 103.6 endorsement, available with the ALTA lender's policy, ensures the lender that none of the improvements encroach onto a particular easement. If the underwriting examination indicates that the endorsement cannot be issued because improvements do encroach onto an easement, other endorsements may be considered. The CLTA 103.1 endorsement covers loss arising from a claim to use a particular easement.

PRACTICE TIP: If the property is subject to an easement, the owner may wish to request a CLTA 103.1 endorsement instead of the CLTA 100 endorsement. The CLTA 103.1 endorsement insures against *any* loss suffered from the exercise of any right to use or maintain an easement disclosed in the title policy, while the CLTA 100 endorsement is limited to losses resulting from damage to existing improvements located or encroaching upon the easement. The title company may refuse to issue the CLTA 103.1 endorsement if the easement is a locatable or an active easement.

The CLTA 103.3 endorsement covers a forced removal of improvements that encroach on the easement. These endorsements are available in conjunction with both the CLTA policy and the ALTA lender's policy.

The CLTA 103.9 endorsement, available with an ALTA lender's policy, insures against the forced removal of improvements built into a public street by a government agency. The endorsement requires that the improvements be built in accordance with specified plans.

PRACTICE TIP: A good use of the CLTA 103.9 endorsement is when the owner constructs improvements in public rights of way or within public easements in accordance with an encroachment removal permit issued by a public agency.

See §§8.51-8.58 for a general discussion of the CLTA 100 endorsement, which offers other encroachment coverages.

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§8.76 2. Underwriting Criteria

Before issuing a CLTA 103.1 endorsement, the title insurance company may investigate:

- The location and purpose of the easement;
- The likelihood of exercise of rights under the easement (whether rights have been abandoned);
- Any damage to improvements if rights under the easement are exercised; and
- Any damage caused by maintenance of the easement.

The title insurance company will investigate the purpose of the easement and the effect of its maintenance or use before issuing a CLTA 103.3 endorsement. The company may require an examination of the construction plans before it will issue a CLTA 103.9 endorsement.

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L. Environmental Lien Protection

§8.77 1. CLTA 110.9 (ALTA Form 8.1) Endorsements

To meet FNMA requirements for protection against existing environmental liens, the CLTA 110.9 endorsement (identical to ALTA Form 8.1) is used with an ALTA lender's policy. It is issued for residential property (although some title insurance companies offer a modified version for commercial property) and ensures the lender that no recorded federal or state environmental protection liens existed at the date of the policy. (*Lick Mill Creek Apartments v Chicago Title Ins. Co.* (1991) 231 CA3d 1654, 1662, 283 CR 231, indicates that the title policy does not cover environmental lien matters, even under the "marketability of title" clause.)

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§8.78 2. Underwriting Criteria

The underwriter will confirm that the property insured is residential property.

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M. Foundations

§8.79 1. CLTA 102.4, 102.5, 102.6, and 102.7 Endorsements

After completion of foundations, the construction lender may require issuance of the CLTA 102.4 or 102.5 endorsements to obtain insurance that the foundation of the structure under construction is within the boundary lines of the insured property and that the location of the foundation does not violate the CC&Rs. The CLTA 102.5 endorsement also insures that the foundations do not encroach onto any Schedule B easements. During construction, the construction lender often requires a CLTA 102.4 or 102.5 endorsement to obtain insurance that the foundations are properly located before authorizing further loan disbursements. These endorsements are available in conjunction with both the CLTA policy and the ALTA lender's policy.

The CLTA 102.6 and 102.7 endorsements, similar to the CLTA 102.4 and 102.5 endorsements, are used when only a portion of the insured land is built upon, *e.g.,* if foundations are built on only a few lots in a development. They are available with both the CLTA policy and the ALTA lender's policy.

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§8.80 2. Underwriting Criteria

Underwriting requirements for these endorsements may include a physical inspection of the property and a surveyor's certification that the foundations are properly placed on the insured parcels.

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N. Leases

§8.81 1. CLTA 119, 119.2, 119.3, 124.2, and 124.3 Endorsements

The CLTA 119 endorsement ensures the lender that a lease was properly executed and specifies the priority of the lease. It is available for both the CLTA policy and the ALTA lender's policy. The CLTA 119.2 endorsement is used with an ALTA lender's policy for a lender relying on the value of the lease (oil or commercial) as security for the lien. It states that the lease is "valid and subsisting" at the date of the policy. The CLTA 119.3 endorsement protects the insured if the priority of the lease with respect to the insured deed of trust is in doubt. Both the CLTA 119.2 and 119.3 endorsements are available with the ALTA lender's policy.

Two endorsements are available to ensure the lender that the lessor's covenants are binding on the lessor's successors. The CLTA 124.2 endorsement covers affirmative covenants, and the CLTA 124.3 endorsement covers negative covenants. Both are available with the CLTA policy and the ALTA lender's policy, and both are limited to public record matters (even if issued in connection with the ALTA lender's policy).

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§8.82 2. Underwriting Criteria

Before issuing any lease endorsements, the underwriter will examine the lease. In particular, in light of the holdings in *Principal Mut. Life Ins. Co. v Vars*, *Pave, McCord & Freedman* (1998) 65 CA4th 1469, 77 CR2d 479, *Miscione v Barton Dev. Co.* (1997) 52 CA4th 1320, 61 CR2d 280, and *Dover Mobile Estates v Fiber Form Prods.* (1990) 220 CA3d 1494, 270 CR 183 (see §§5.15, 8.19), the underwriter will need to examine any automatic subordination provisions and attornment clauses in the lease as well as pre- and post-foreclosure actions of the lender and the tenant, to determine if they alter the priority of the subject lease. Because title companies are neither comfortable with nor accustomed to this type of review, they may minimize their risk by requiring the parties to the lease to provide an estoppel letter, confirming the continuing validity of the lease, particularly after foreclosure of a lien on the subject property.

The CLTA 124.2 and 124.3 endorsements are limited to specific covenants. The underwriter will further require:

- Recordation of the lease or a short form that specifically includes the covenants being insured; and
- A public records search.

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O. Mechanics' Lien Priority

§8.83 1. CLTA Series 101 Endorsements

The ALTA lender's policy covers some mechanics' lien matters. See §6.30. The CLTA series 101 endorsements expand the standard coverage of the CLTA policy or amplify the extended coverage of the ALTA lender's policy. (If advances are being made, several endorsements provide added insurance; see §§8.61-8.62.) Some mechanics' lien endorsements are tailored for construction lenders; others are for take-out or permanent lenders.

The CLTA 101 endorsement ensures the lender against loss of priority resulting from mechanics' liens based on work commenced before recordation of the deed of trust. It basically restates the extended coverage provided by the ALTA lender's policy. There are many variations of this endorsement.

The CLTA 101.2 endorsement insures against loss of priority based on mechanics' liens related to work referred to in a recorded notice of completion. The following modifications are also available:

- CLTA 101.5 endorsement, limiting liability to the amount stated in the endorsement;
- CLTA 101.6 endorsement, limiting liability to the policy amount;
- CLTA 101.10 endorsement, covering specific lots described in the notice of completion; and
- CLTA 101.13 endorsement, covering a notice of completion recorded for all land covered by the policy.

If no notice of completion has been recorded, the CLTA 101.3 and 101.11 endorsements insure against loss of priority from a mechanics' lien when construction is completed. These endorsements are used with both the CLTA policy and the ALTA lender's policy.

If the ALTA construction loan policy is used instead of the ALTA lender's policy (see §§8.34-8.38), CLTA endorsements are available to cover priority of the loan:

- If a notice of completion has been recorded (CLTA 101.14 endorsement);
- If no notice of completion has been recorded (CLTA 101.15 endorsement); or
- If liability is limited to the amount stated in the endorsement (CLTA 101.16 endorsement).

See also §7.88 for discussion of mechanics' lien endorsements.

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§8.84 2. Underwriting Criteria

Before issuing the CLTA series 101 endorsements, the underwriter may require an inspection and an indemnity. If the endorsement refers to a notice of completion, the underwriter will ascertain whether the statutory time limits have passed for filing claims. The company may require that an acceptable statutory bond be recorded under CC §3138 or §3199 before it will issue the CLTA 101.3 or 101.11 endorsements.

NOTE: The insurer may also request evidence of a binding agreement between the lender and the borrower on use of the loan proceeds as specified in CC §3137. The typical site improvement loan agreement calling for disbursement in installments, according to the progress of the work, probably does not meet the requirements of CC §3137. See *Schmitt v Tri-Counties Bank* (1999) 70 CA4th 1234, 83 CR2d 257, holding in favor of a mechanics' lien claimant against a construction lender based on the court's finding that the bank had not complied with CC §3137 and therefore lost the priority of its deed of trust. If work has started before recordation, an insurer may be willing to insure on the recordation of a payment bond under CC §3139; however, the doubtful protection of these bonds sharply limits their acceptance. Although insurers are sometimes willing to accept indemnity agreements from owners or contractors as a means of providing insurance for site improvement or construction loans of doubtful priority, they will also usually require suitable security for such indemnification, accepting it only after careful study of the soundness of both the project and the various parties concerned.

See also §7.89 for discussion of underwriting criteria for mechanics' lien endorsements.

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P. Mineral or Water Extraction

§8.85 1. CLTA 100, 100.23-100.26, 100.29, and 103.5 Endorsements

A lender that desires coverage against loss or damage from surface extraction of minerals under an oil or gas lease, as shown in Schedule B, should use the CLTA 100.23 endorsement. The CLTA 100.24 endorsement ensures the lender that the holder of a mineral lease shown in the Schedule B exceptions has no right of entry onto the insured land. Both endorsements can be used with an ALTA lender's policy.

The CLTA 100.25 endorsement (designed primarily for use with the CLTA oil leasehold policy) ensures the lender that there is no final judgment holding that the lessee violated the CC&Rs by subsurface oil drilling.

The CLTA 100.29 endorsement is available with both the CLTA policy and the ALTA lender's policy to insure the lender against loss from damages to existing improvements resulting from the use of the surface for extracting or developing minerals.

Potential damage to improvements arising from a right to extract water is covered by the CLTA 103.5 endorsement, which is used with the ALTA lender's policy.

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§8.86 2. Underwriting Criteria

The underwriter will examine:

- The lease, to ascertain whether there is a right of surface entry; and
- Zoning regulations, to ascertain whether mineral development is prohibited.

For the CLTA 100.25 endorsement, the underwriter will review the CC&Rs to learn whether mineral extractions are prohibited.

The underwriter will review any waiver of surface entry rights before issuing a CLTA 100.29 endorsement. If the rights have not been waived, the underwriter may review any or all of the following:

- The geologic history of the property;
- The zoning of the property;
- The extent and character of improvements;
- The nature and quality of any outstanding mineral interest; and
- The amount of mineral, oil, or gas activity in the area.

Before issuing the CLTA 103.5 endorsement, the underwriter will require a release of surface rights. If a release is not given, the underwriter will try to ascertain whether water rights will be asserted.

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Q. Modifications, Changes in Loan Terms, Increases in Line of Credit

§8.87 1. CLTA 110.4, 110.5, 110.6, 110.10, and 108.10 Endorsements

Lenders may agree to modify a loan for many reasons. The CLTA 110.4 and 110.5 endorsements are valuable tools for an insured lender who consents to a change in the terms of the loan.

Lender's counsel will be concerned that any substantive change to the loan documents (*e.g.*, a change in the interest rate, an extension of the note's due date, or a change to the described security) may cause a junior lienholder to complain that the position of its junior lien has been jeopardized by a modification to the senior lien. The CLTA 110.4 and 110.5 endorsements, both of which are used with an ALTA lender's policy, are designed to ensure the senior beneficiary that the priority of its deed of trust is not jeopardized by the modification.

NOTE: Some lenders argue that a loan modification that decreases the note's interest rate or extends the maturity date of an otherwise overdue loan actually benefits the junior lienholder's position, and therefore does not justify the cost of obtaining the endorsement. See *Lennar Northeast Partners v Buice* (1996) 49 CA4th 1576, 57 CR2d 435 (loss of lender's priority is only for increased loan amount, not entire debt). See also *Gluskin v Atlantic Sav. & Loan Ass'n* (1973) 32 CA3d 307, 108 CR 318.

The CLTA 110.4 endorsement ensures the lender that the loan has been modified. It does not insure the priority of the lender's deed of trust.

During the modification process, lenders usually require insurance of the priority of the modification to the loan. The CLTA 110.5 endorsement fulfills this requirement by ensuring that the deed of trust is prior to all matters shown in Schedule B of the policy or other matters excepted from the endorsement. It usually costs more than the CLTA 110.4 endorsement. The endorsement is subject to the policy's terms and conditions. If an older policy form was issued, the underwriter may require insertion of a creditors' rights exclusion to exclude any claim that the modification is a fraudulent or preferential transfer. On creditors' rights exclusion, see §§6.48, 6.88, 7.18-7.20, 8.32, 11.78.

The CLTA 110.6 endorsement is designed for use with a CLTA policy or an ALTA standard coverage policy and provides the same coverage as a CLTA 110.5 endorsement. The CLTA 110.10 endorsement combines the CLTA 110.5 and 108.8 endorsement coverages except that it includes the creditors' rights exclusion and assures against loss if the modification causes the insured deed of trust to become invalid or unenforceable. Upon request, the title company may delete the creditors' rights exclusion. The CLTA 108.10 endorsement is designed to insure a specified increase in a borrower's line of credit by insuring title of the vestee, priority of the deed of trust, and the absence of reconveyances, modifications, or subordinations except as specifically stated in the endorsement. It can be used with both a CLTA policy or an ALTA lender's policy.

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§8.88 2. Underwriting Criteria

Some insurers take the view that a junior lienholder is not jeopardized by a modification (particularly if the loan would go into default without the modification), while others are concerned that a junior could assert that the decision to make the junior loan was based on a set of assumptions that the senior beneficiary may not change without the subordination or consent of the junior lienholders.

Before issuing a modification endorsement, most title insurance companies will do a datedown of title and may require recordation of a document providing notice of the modification. Some insurers provide a modified (and less expensive) CLTA 110.5 endorsement if the lender represents that the only change to the loan is an extension of the maturity date. The company may also run a general title search to confirm that the note holder is a party to the modification agreement. In addition, the CLTA 110.5 and 108.10 endorsements may require an inspection of the property. The company may also require the junior lienholder to execute a recordable subordination.

If the modification changes the description of the insured security, the prevailing underwriting view is that the CLTA series 110 endorsements are insufficient. Consequently, the policy is reissued with the property description modified to include the new security. If there is also a partial reconveyance, the CLTA 111 endorsement should be issued. See §§8.91-8.92.

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R. Multiple Security: Separate Deeds of Trust; Separate Parcels

§8.89 1. CLTA 105 and 105.1 Endorsements

The CLTA 105 and 105.1 endorsements insure two separate deeds of trust under one policy. The CLTA 105 endorsement is used with an ALTA lender's policy, and the CLTA 105.1 endorsement is used with a CLTA policy.

PRACTICE TIP: If two deeds of trust are recorded on two separate parcels, counsel should be alert to potential dual security issues. The title insurance company may issue two separate policies, especially if the parcels are in separate counties. The deeds of trust should refer to each other if they are intended to secure the same debt. Special attention should be paid to the potential for handling a foreclosure without violating the one-action rule of CCP §726. This process should be considered before recording the separate deeds of trust. On one-action rule generally, see California Mortgages, Deeds of Trust, and Foreclosure Litigation §§9.5-9.6 (4th ed Cal CEB 2009).

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§8.90 2. Underwriting Criteria

The title insurance company typically attaches the CLTA 105 or 105.1 endorsement if two deeds of trust are recorded concurrently.

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S. Partial Reconveyances

§8.91 1. CLTA 111, 111.1, and 111.3 Endorsements

A senior lender may also consider whether its issuance of a partial reconveyance will jeopardize a junior lienholder's position. On jeopardizing junior lienholders, see §§8.87-8.88.

EXAMPLE: Assume that a beneficiary with a first position records its deed of trust against two lots, Blackacre and Greenacre. A junior with a lien against Blackacre may complain that a reconveyance of the first lender's lien against Greenacre jeopardizes the junior lienholder's position because the reconveyance of only one lot unfairly burdens Blackacre with all the remaining debt. See *Woodward v Brown* (1897) 119 C 283, 291, 51 P 542 (where part of the security is released for less than its full value and there is a junior lien on the balance of the security, the junior lienholder may object because the senior's actions deprived the junior of any chance for a surplus on foreclosure); *Thompson v Thomas* (1919) 43 CA 588, 590, 185 P 427.

The CLTA 111 endorsement ensures the lender that the partial reconveyance does not impair the lender's lien. The CLTA 111.1 endorsement insures that the partial reconveyance does not reduce the stated policy liability amount. The CLTA 111.3 endorsement provides that the partial reconveyance has not impaired the insured lien and that there are no encroachments on the remaining land. The coverage of this endorsement is a combination of the CLTA 100 (paragraph 1(d)), 111, and 116 endorsements. All are available for both the CLTA policy and the ALTA lender's policy.

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§8.92 2. Underwriting Criteria

The underwriter may examine the language of the first deed of trust to see whether it expressly allows for future partial reconveyances without affecting the security or liability due under the deed of trust. Such a recorded release provision appears to bind the junior lienholder. See *Thompson v Thomas* (1919) 43 CA 588, 185 P 427, for an example of such a release provision. In the absence of a future release clause in the first deed of trust, the underwriter may require consents from all junior lienholders affected by the contemplated partial reconveyance.

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T. Property Description

§8.93 1. CLTA 116, 116.1-116.7 Endorsements

The CLTA 116 endorsement is commonly issued in conjunction with the CLTA 100 endorsement and is available with the ALTA lender's policy. See §§8.51-8.58. It ensures the lender that the character of the improvements are as stated in the policy and that the street address and the dimensions and location of the insured land as shown on the map attached to the policy are accurate. Other endorsements that are available under either a CLTA policy or an ALTA lender's policy will insure that:

- The attached survey correctly delineates the insured land (CLTA 116.1 endorsement);
- If the description of the insured land has changed (for instance, if a parcel or subdivision map is recorded after recordation of the deed of trust), the new description is accurate (CLTA 116.3 endorsement); and
- The subdivision parcel was lawfully created (CLTA 116.7 endorsement).

Lenders should be aware of the limitations of the CLTA 116 endorsement. In *Golden Sec. Thrift & Loan Ass'n v First Am. Title Ins. Co.* (1997) 53 CA4th 250, 61 CR2d 442, the court held that the reference to "dimensions" in the CLTA 116 endorsement does not confirm that the "area" shown on the plat attached to the policy is accurate, given that dimensions refer only to a linear measurement. These dimensions also are based on the public records and depend on the accuracy of such records. As such, lenders concerned with acreage should independently ascertain this measurement in an ALTA survey.

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§8.94 2. Underwriting Criteria

Before issuing the CLTA 116.1 endorsement, the title insurance company will review the survey. For the CLTA 116.3 endorsement, the title insurance company will try to verify that the land described in the policy corresponds to that designated on the subdivision or parcel map.

The CLTA 116.7 endorsement may be issued if the property insured is all of a lot or parcel on the map or if a certificate of compliance (*i.e.*, a certificate issued by a local agency determining that the property complies with the Subdivision Map Act (Govt C §§66410-66499.37)) for the property is recorded. Metes and bounds descriptions qualify for this endorsement even when there is no certificate of compliance. On certificates of compliance generally, see California Subdivision Map Act and the Development Process §§11.16-11.21 (2d ed Cal CEB 2001).

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U. Subordinations

§8.95 1. CLTA 111.2 Endorsement

If the insured lender subordinates its lien, the CLTA 111.2 endorsement ensures the lender that the subordination is valid and that the insured lien is subordinated only to the matter set forth in the recorded subordination agreement.

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§8.96 2. Underwriting Criteria

A recorded subordination agreement is necessary for the issuance of a CLTA 111.2 endorsement. Title insurance companies prefer using their standard form subordination agreement because it alleviates the companies' concerns about hidden conditions in the subordination agreement. On subordination agreements generally, see California Mortgages, Deeds of Trust, and Foreclosure Litigation §§9.76-9.85 (4th ed Cal CEB 2009).

Construction financing frequently requires subordination of a purchase money deed of trust to a later construction loan deed of trust affecting the same property. Purchase money encumbrances are rarely inferior to mechanics' liens, but construction loan deeds of trust frequently lack priority over mechanics' liens because they are recorded after work commences on the project. A question arises as to what effect subordination of a superior purchase money encumbrance to a construction loan deed of trust will have on its previous priority over mechanics' liens. No California decision has answered this question. Title insurers generally believe that the subordinated purchase money deed of trust loses its priority over the construction deed of trust only and not over mechanics' liens. On the other hand, construction deeds of trust in such cases are still inferior to mechanics' liens. This viewpoint results in a classic example of circuity of lien priority, with the purchase money loan superior to mechanics' lien claims, which in turn are superior to the construction loan deed of trust, which itself is superior to the purchase money encumbrance. In other words, the subordination affects only the immediate parties.

This view of the circuity problem is not universally held. Some attorneys believe that subordination of the purchase money encumbrance to the lien of the construction loan operates to subordinate it to the mechanics' liens and that claimants do not have to protect themselves against foreclosure of the purchase money lien. How the courts will finally decide the issue is still an open question. On circuity of liens, see 3 Miller & Starr, California Real Estate §7:78 (3d ed 2000).

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V. Truth in Lending

§8.97 1. CLTA 125 (ALTA Form 2) Endorsement

Exclusion 5 of the ALTA lender's policy excepts from coverage any loss or damage resulting from the invalidity or unenforceability of the lien of the insured deed of trust for claims arising from the insured lending transaction, based on any consumer credit protection or truth-in-lending laws. The CLTA 125 endorsement (identical to ALTA Form 2) is designed to provide lenders who have an ALTA lender's policy with coverage for loss or damage arising from an exercise of the right of rescission, conferred by the federal Truth in Lending Act (15 USC §§1601-1693r), if the right of rescission existed because neither the credit transaction evidenced by the insured deed of trust nor the right of rescission of the deed of trust was exempted by Regulation Z (12 CFR §§226.1-226.34). (Regulation Z, requiring creditors to make certain disclosures, applies to credit sales and other types of consumer credit transactions.)

The primary exceptions under this Act are extensions of credit:

- To borrowers who are not natural persons (*e.g.,* corporations, trusts, and partnerships); or
- For business or commercial purposes, other than agricultural purposes.

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§8.98 2. Underwriting Criteria

Title insurance companies will issue this endorsement only if the transaction that is the subject of the policy was exempt from the federal Truth in Lending Act (15 USC §§1601-1693r). Note that the loss or damage covered must be sustained by a final court order or judgment deciding the matter insured against. See §8.50.

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W. Variable or Adjustable Interest Rates

§8.99 1. CLTA 111.5-111.8 (ALTA Forms 6, 6.1, and 6.2) Endorsements

If the lender's deed of trust secures a variable interest rate loan, the CLTA 111.5-111.8 endorsements ensure the lender that the change in the interest rate will not affect the validity, enforceability, or priority of the insured lien. The CLTA 111.5 (identical to ALTA Form 6) endorsement is primarily available with an ALTA lender's policy. The CLTA 111.6 (identical to ALTA Form 6.1) and 111.7 endorsements are available for both the CLTA policy and the ALTA lender's policy. The CLTA 111.8 (identical to ALTA Form 6.2) endorsement has the broadest coverage and includes defined changes in interest rates, interest on interest, and addition of interest amounts to the unpaid principal balance. It can be used if the loan contains a negative amortization feature and is available with both the CLTA policy and the ALTA lender's policy

The CLTA 111.10 and 111.11 endorsements are designed to handle changes in interest rates that involve optional and obligatory advances, respectively. See §§8.61-8.62.

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§8.100 2. Underwriting Criteria

The CLTA 111.5 endorsement (meant for use with conventional lenders) and the CLTA 111.6 and 111.7 endorsements require that the recorded loan documentation disclose that the loan is subject to a variable interest rate. The CLTA 111.8 endorsement requires that the deed of trust (or a rider to it) contain a detailed description of the negative amortization feature of the loan and a clear statement that, because the payments are not sufficient to pay the accrued interest, it will therefore be added to the principal.

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§8.101 X. Zoning (CLTA 123.1 and 123.2 (ALTA Forms 3 and 3.1) Endorsements)

The CLTA 123.1 (identical to ALTA Form 3) and the CLTA 123.2 (identical to ALTA Form 3.1) endorsements specify the property's zoning classification and uses permitted under that classification, subject to compliance with applicable CC&Rs, including obtaining necessary permits. The CLTA 123.1 endorsement is used for unimproved land, and the CLTA 123.2 endorsement is used if there are existing improvements. It insures the lender against a loss resulting from a final judgment that either prohibits use of the land with the existing structure or requires alteration or removal of the existing structure based on a specified ordinance. Both are available for the CLTA policy and the ALTA lender's policy. On exclusion of zoning matters from title coverage, see §6.36. For discussion of zoning endorsement coverage, see §§7.97-7.98.

PRACTICE TIP: Zoning endorsements are very expensive, and many borrowers resist the lenders' requests for these endorsements. Other sources of assurance on zoning for lenders include architect's certificates, certificates of occupancy, and legal opinions. However, these sources of assurances may not provide lenders with adequate recourse in the event that they prove to be wrong. As such, evaluation of zoning endorsements should be made on a case by case basis. It is not always appropriate to require their issuance, but in certain situations where either risks or liabilities are high, the added expense may be well justified.

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§8.102 V. ALTA ENDORSEMENT FORMS

In addition to the CLTA endorsement forms, the American Land Title Association (ALTA) has its own series of endorsement forms, all of which are designed to protect the lender and are issued in conjunction with an ALTA lender's policy. Most of these ALTA forms have comparable CLTA forms. The following is a brief summary of the ALTA endorsements:

- Form 1—priority of lien over assessments for certain street improvements;
- Form 2—truth in lending (see §§8.97-8.98);
- Forms 3 and 3.1—zoning (see §8.101);
- Forms 4 and 4.1—matters affecting condominiums (see §§8.68-8.69);
- Forms 5 and 5.1—matters affecting planned unit developments (see §§8.68-8.69);
- Forms 6 and 6.1—variable interest rate (see §§8.99-8.100);
- Form 7—matters affecting manufactured housing units;
- Form 8.1—environmental liens (see §§8.77-8.78);
- Form 9—restrictions, encroachments, and minerals (see §§8.51-8.58);
- Forms 10 and 10.1—assignments of deed of trust (see §§8.63-8.64);
- Form 11—mortgage modification;
- Form 12—aggregation of liabilities of multiple policies (see §§8.115-8.116); and
- Forms A, B, C, and D—construction loan endorsements (see §§8.35-8.36).

If the ALTA forms cannot be readily found in the endorsement books of local title insurance companies, they are available in the Appendix to Burke, Law of Title Insurance (3d ed 2000).

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§8.103 VI. TITLE INSURANCE COMPANY ENDORSEMENTS

Some title insurance companies offer individualized endorsements to meet the insured lender's special needs. These endorsements are not authorized as a CLTA or ALTA form, because they have usually been developed to meet the needs of a particular lender or loan transaction.

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A. Doing Business

§8.104 1. Purpose of Endorsement

Some title insurance companies provide coverage to out-of-state lenders for a loss arising under a claim that the lien of the insured mortgage is unenforceable under California's "doing-business" laws. This endorsement has the effect of modifying the doing-business exclusion in the ALTA lender's policy. See §6.46.

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§8.105 2. Underwriting Criteria

Underwriters may require an investigation into the applicability of an exception to the requirement that foreign businesses must qualify to do business in California. The insurer may require a statement that recording the deed of trust is a one-time act in California and not one of a series of transactions under Corp C §191.

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B. First Loss Payable Endorsement

§8.106 1. Purpose of Endorsement

This endorsement is used if several parcels of property are used as security for the same deed of trust. If a loss results from a title defect, a lien, or an encumbrance insured against by the policy on one property, the title insurance company will be liable for that loss to the insured without first requiring the insured to foreclose and sell other insured properties not affected by the defect, lien, or encumbrance. Some versions of this endorsement waive the requirement that the lender also foreclose on the affected property. This endorsement makes the measure of damages in a lender's policy closer to the measure of damages in an owner's policy.

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§8.107 2. Underwriting Criteria

Because the title insurance company is assuming a greater risk that damages will be payable under this endorsement, the company may underwrite this endorsement the way it would underwrite an owner's (rather than a lender's) policy. This may mean, for instance, that the survey requirement for an extended coverage policy will not be waived.

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C. Last-Dollar Endorsement

§8.108 1. Purpose of Endorsement

If a loan is secured by both real and personal property, the loan amount may exceed the value of the real property. Nonetheless, the deed of trust may state that it secures the full amount of the indebtedness. The title policy amount, however, will equal the value of the real property, which is less than the amount secured by the deed of trust. The policy provides that any principal payment received by the lender from any source will reduce the liability available under the policy dollar for dollar (see Condition 9). The last-dollar endorsement provides that payments on the loan will *not* reduce the insurer's liability under the policy until the loan is paid down to the policy liability amount. This endorsement permits title insurance to remain in effect until the entire loan amount is repaid.

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§8.109 2. Underwriting Criteria

The title insurance company will ask the lender to confirm that the obligation secures both real and personal property and that payments will be applied first to reduce the lien secured by the collateral property.

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§8.110 D. Nonimputation Endorsement

When a lender participates as a partner in a project, the lender will want a nonimputation endorsement to ensure that knowledge of the partnership and its partners will not be imputed to the lender, tainting the lender's policy coverage. This endorsement may also be issued in connection with stock purchases. The nonimputation endorsement is available for an ALTA lender's policy. See §§7.101-7.102 for full discussion of this endorsement. This endorsement is expensive.

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E. Revolving Line of Credit

§8.111 1. Purpose of Endorsement

A revolving line of credit loan allows the borrower to borrow, pay, and reborrow the original loan amount. Several title insurance companies provide a revolving credit line endorsement, insuring the priority of the revolving credit advance.

This endorsement does not exceed the face amount of the policy and requires the borrower to own the insured property on the date of the advance. Excluded from priority coverage of the endorsement are intervening federal tax liens, liens actually known by the advancing lender before the advance, and bankruptcies affecting the borrower.

An adaptation of the revolving credit endorsement insures against a loss of priority arising from changes in interest rates secured by the deed of trust. The CLTA 108.10 endorsement ensures an additional increase in the line of credit. See §§8.87-8.88.

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Source: Real Property/California Title Insurance Practice/8 Lender's Policies and Endorsements/§8.112 2. Underwriting Criteria

§8.112 2. Underwriting Criteria

Underwriting concerns require a confirmation that the lien of the deed of trust contains appropriate language to secure advances by the lender.

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F. Shared Appreciation Mortgage

§8.113 1. Purpose of Endorsement

One innovative financing mechanism offers lenders a share of future appreciation of the borrower's property (also known as an "equity kicker"). Largely a creature of high interest rates or loan qualification issues, the shared appreciation mortgage is sought to secure the priority and right of a lender to share in a future appreciation of the property. Civil Code §1917 defines this type of loan. The endorsement insures the priority, validity, and enforceability of the lien of an insured deed of trust, which provides for additional interest in the form of the share in the appreciation in the value of the land. This endorsement is used with an ALTA lender's policy.

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§8.114 2. Underwriting Criteria

Underwriting requirements may include a review of the loan documentation to confirm that the recorded loan documents state that the loan secures a shared appreciation loan. If the property is residential, the loan must comply with CC §1917.006. If the secured property is not residential, the loan must comply with CC §§1917(b) and 1917.004(b).

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G. Tie-in Endorsement

§8.115 1. Purpose of Endorsement

The tie-in endorsement (also known as a "cluster" or "aggregation" endorsement) is used if the debt is secured by multiple deeds of trust insured by multiple policies. It is frequently used when the secured properties are located in several states. The tie-in endorsement permits the cumulative liabilities of the multiple policies that are tied together to be available to any one or more properties for any given loss. The advantage to the insured is that, if a parcel that sustains a loss has increased in value since the policy was issued, the insured can recover based on the increased value of that property. Any payment of a claim on any policy reduces the title insurance company's aggregate liability under all policies listed in the tie-in endorsement. The ALTA Form 12 and CLTA 117 endorsements are tie-in endorsements.

NOTE: A great advantage of this endorsement is the flexibility it provides lenders in claim situations.

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§8.116 2. Underwriting Criteria

The title insurance company generally confirms that all deeds of trust affected by the tie-in endorsement are cross-collateralized.

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H. Usury

§8.117 1. Purpose of Endorsement

Claims based on usury that result in a finding that the lien of the insured mortgage is invalid or unenforceable are also excluded under Exclusion 5 in an ALTA lender's policy, in the same manner as losses attributed to certain truth-in-lending violations as discussed in §§8.97-8.98. Most title insurance companies are willing to issue an endorsement (which varies in form from company to company) insuring that the insured deed of trust is valid or enforceable (under the applicable jurisdiction's usury laws) as to the principal and interest due on the note secured by the deed of trust, as long as the interest is computed in accordance with the deed of trust and the note.

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§8.118 2. Underwriting Criteria

The title insurance company will require a copy of the note and will ascertain whether the interest rate stated is usurious or whether the lender is exempt from California's usury laws. Loss or damage under this endorsement must be sustained by a final court order or judgment deciding the matter insured against. See §8.50. A legal opinion may also be required.

NOTE: Despite the availability of the usury endorsement, most lenders rely on a legal opinion to advise on usury.

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9

Guaranties and Limited Coverage Policies

David V. Westcott

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§9.1 I. DISTINCTIONS BETWEEN GUARANTIES AND POLICIES

In addition to providing title policies, title companies offer a variety of guaranties related to title matters. These guaranties are offered to meet specific needs and thus provide more limited coverage than title policies provide. For instance, a trustee's sale guaranty gives the trustee conducting a nonjudicial foreclosure the information needed from the public records to give notice to the owner and junior beneficiaries on the property. It is not a title policy, however, and cannot be relied on by a purchaser at the foreclosure sale. See also §7.5.

Guaranties also differ significantly from title policies in the coverage furnished for attorney fees and costs. The insuring provision for these fees and costs, as shown on the face page of the title policy (see §§6.19-6.33), is not present in the guaranty. An insurer may opt to defend or prosecute an action arising under a guaranty but has no duty to do so. See §9.5. Thus, the guaranty is only a contract of indemnity for actual loss.

Some guaranties (*e.g.,* recorded document, chain of title) are issued for nominal liability amounts such as $100 or $1000. Although the actual damage that the purchaser could suffer may greatly exceed these low liability limits, they make the guaranty available for a relatively nominal cost and are, therefore, an acceptable risk to the purchaser in some situations. In this situation, the guaranty may be more appropriately viewed as a source of information rather than a true insurance product.

Other guaranties (*e.g.,* litigation or trustee's sale) give the purchaser the option of setting the liability amount. The prudent approach with these guaranties is to establish liability limits commensurate with the damages that might arise if the information proves to be incorrect. In this situation, the guaranty does act as a more traditional insurance product.

This chapter analyzes the most commonly issued guaranties. The examples cover the great majority of situations in which a purchaser needs a title product to meet a specific need. Guaranties are not limited, however, to the situations discussed below. Counsel needing a guaranty for a situation not discussed should consult with a title company officer about possible availability. In considering the appropriateness of a guaranty for a particular situation, counsel should always keep in mind the limited scope of search that will be made, as well as the more limited coverage that will be provided.

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II. BASIC GUARANTY STRUCTURE

§9.2 A. Face Page

The face page of the guaranty is generic for most guaranties. (The major exceptions are a trustee's sale guaranty (see §§9.6-9.8) and a litigation guaranty (see §§9.9-9.12), each of which sets forth on the face page the actual assurances being given, and a recorded document guaranty (see §§9.16-9.17), which specifies on the face page that the guaranty is valid only when accompanied by the application for issuance.) The face page subjects the Schedule A assurances to the exclusions, limits of liability, and conditions and stipulations of the guaranty.

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Source: Real Property/California Title Insurance Practice/9 Guaranties and Limited Coverage Policies/§9.3 B. Schedule A

§9.3 B. Schedule A

The actual assurance being given is in Schedule A, which varies with the specific assurance given by the particular guaranty. For instance, Schedule A of the mechanics' lien guaranty provides assurances on recorded notices of completion, mechanics' liens, and notices of pending actions to foreclose mechanics' liens. In contrast, a judgment and tax lien guaranty provides assurances on recorded federal tax liens, abstracts of judgment, and certificates of state tax liens.

Schedule A also shows the liability amount, the fee charged, the date of the guaranty, the name of the assured, and an identification number assigned by the title company.

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§9.4 C. Schedule of Exclusions

The exclusions from coverage have two parts. The first part is a broad exclusion for such things as taxes, assessments, water rights, defects, liens, and other matters against the title *except* to the extent specific assurances are given in Schedule A. The result is that only the specific, limited purpose of the guaranty as set forth in Schedule A is covered.

The second part of the exclusions limits even the coverage given in Schedule A. For instance, matters created or assumed by the assured are excluded. Also, the validity or priority of any matter shown in the guaranty is excluded from coverage. Thus the guaranty shows matters found of record that relate to the specific type of guaranty being issued, but the validity or priority of the matters found is not covered.

EXAMPLE: Assume that counsel for a beneficiary under a deed of trust obtains a trustee's sale guaranty in connection with a nonjudicial foreclosure. The guaranty gives no assurances of the deed of trust's priority or that it is a valid or enforceable lien. A title policy must be obtained for these purposes.

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§9.5 D. Conditions and Stipulations

The conditions and stipulations of the guaranty are generic for almost all the guaranties. (The recorded document guaranty is the main exception because its own provisions are built into its application; see §9.16.)

The conditions and stipulations of a guaranty have many similarities to the conditions and stipulations of a title policy. For example, the definition of "public record" as it relates to policies and guaranties issued in California is the same (see §§4.1, 6.62), but there are some important differences. The definition of "assured" is limited to the parties named in the guaranty. This definition is much more limited than the title policy definition of "insured," which includes assignees of an insured mortgagee and heirs or devisees of an insured owner. See §§6.60-6.61. In addition, paragraph 3 provides that the issuer has no *duty* to defend or prosecute an action, though it does have the *option* to do so in paragraph 4. Insurers, however, rarely exercise this option.

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III. COMMONLY ISSUED GUARANTIES

A. Trustee's Sale Guaranty

§9.6 1. Purpose

The trustee of a deed of trust, preparing a nonjudicial foreclosure after recording a notice of default, needs assurances of the identity of (a) the vested owner of the property and (b) other parties (*e.g.,* beneficiaries of junior deeds of trust or parties who have recorded requests for notices of default) who are entitled by statute to receive notice of the foreclosure. See CC §2924b. This information is usually obtained by purchasing a trustee's sale guaranty.

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§9.7 2. Assurances Given

The trustee's sale guaranty gives assurances on:

- The name of the vested owner of the property;
- The names and addresses disclosed of record of persons who have recorded requests under CC §2924b(a), (d) to receive a copy of a notice of default and notice of sale;
- The names and addresses disclosed of record of persons who are otherwise entitled under CC §2924b(c)(1)-(2) to receive notice;
- The names and addresses of the state taxing agencies that are entitled under CC §2924b(c)(2)(F) to receive notice; and
- The city or judicial district where the land is located in order to find a newspaper qualified to publish notice under CC §2924f. Usually, the trustee's sale guaranty lists one or more publications that qualify in that city or district.

E-mail and other forms of electronic addresses do not qualify as the "last known address" of a trustor or mortgagor. CC §2924b(b)(3).

The trustee's sale guaranty may also include a courtesy notice section listing matters such as abstract of judgment creditors found of record. These creditors are not entitled to notice under CC §2924b, but the trustee may choose to send them a notice.

PRACTICE TIP: Because the statutes do not require that courtesy notices be sent to the creditors of record, the beneficiary, if it wishes, should instruct the trustee to do so. An argument can be made that, if the trustee sends out the notice of default as a courtesy, then the notice of sale should also be sent. Also, if some creditors receive a courtesy notice, what about other, similarly situated creditors? Finally, a creditor who received a courtesy notice in a previous, but reinstated, foreclosure proceeding might expect a similar notice in a future foreclosure proceeding of the same obligation.

Lender's counsel should carefully review the information in the trustee's sale guaranty (and litigation guaranty; see §§9.9-9.12) to ascertain whether:

- The record of title has been altered since the deed of trust was recorded;
- A lender's title insurance policy was issued;
- Additional exceptions are shown;
- The legal description differs from that in the deed of trust;
- Vesting has changed; or
- Any priority issues are presented.

Many problems (and title claims) are discovered at this time.

If counsel is simultaneously pursuing a judicial and a nonjudicial foreclosure on the same deed of trust to keep both options open (*e.g.,* because a receiver must be appointed or the beneficiary has not yet decided whether to seek a deficiency), counsel should also request issuance of a litigation guaranty for purposes of filing the judicial foreclosure action. Because the risk is the same and only one remedy can be pursued to completion, counsel should discuss with the title company the pricing of the simultaneous issuance of the trustee's sale and litigation guaranties to be sure that the client does not have to pay two full premiums. Another approach to the cost issue is to ask the title company to price the two guaranties in installments so that the client must pay only if they proceed to completion under one of the guaranties. Obviously, one must have sufficient bargaining power with the title company to pursue this approach. Note also that, if the title company has not already filed this type of pricing with the state department of insurance, it might be considered an illegal rebate under Ins C §§12404-12413.5.

CAVEAT: A prospective bidder at a foreclosure sale cannot rely on the trustee's sale guaranty to ascertain which encumbrances are senior to the deed of trust being foreclosed. The trustee's sale guaranty does not need to list

senior encumbrances to satisfy the assurances given by the guaranty. (A new product being offered by some title companies is the limited trustee's sale guaranty, which eliminates the assurance on all exceptions and replaces it with assurances limited to junior matters.) The trustee's sale guaranty shows encumbrances as exceptions, but they "are not necessarily shown in the order of priority" (trustee's sale guaranty, face page, paragraph 1).

Moreover, the bidder is not a named assured and thus has no claim under the trustee's sale guaranty. See *Harrison v Commonwealth Title Ins. Co.* (1979) 97 CA3d 973, 159 CR 209. Accordingly, the bidder must obtain its own title information in a reliable form. The best form is generally a commitment because the bidder can obtain a title policy after the foreclosure and would have a claim if the commitment omitted a senior encumbrance. See §§5.31-5.38 for discussion of commitments. There is still a practical problem for the prospective bidder to learn the outstanding balance on the senior encumbrance. The senior lender has no obligation under CC §2943 to furnish a statement of condition or a payoff demand to a prospective bidder (unless the prospective bidder has a subordinate lien of record).

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§9.7A 3. Appropriate Issuer

If the foreclosing lender holds an insured deed of trust, it may be prudent to obtain the trustee's sale guarantee from the same title company that issued the lender's policy, so as to eliminate underwriting disputes at the inception of the foreclosure. If the same company is used, it will in all likelihood date down the existing policy (only events subsequent to the original policy are checked) to arrive at the information contained in the trustee's sale guarantee. This has the benefit of expediting processing.

On the other hand, there may be a benefit to obtaining a sale guarantee from a different title company because it allows the lender to obtain a second opinion with respect to the title to the property. However, most lenders are more interested in a prompt foreclosure of their deed of trust, and the benefits of the second opinion may be outweighed by the delay inherent in attempting to reconcile underwriting differences.

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§9.8 4. Limits on Liability

The trustee's sale guaranty is usually purchased in an amount equal to the outstanding loan balance. In addition, the beneficiary may be able to increase the amount to cover anticipated interest that will accrue during the foreclosure proceedings.

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B. Litigation Guaranty

§9.9 1. Purpose

For a litigator, the litigation guaranty is the single most valuable document available from a title company. In any litigation involving real property, counsel must know of all possible interest holders or claimants disclosed by those records that impart constructive notice in order to properly name all parties. An omission may render the judgment obtained useless. The litigation guaranty furnishes this information and transfers liability to the issuer for errors of omitted information. Also, by working with a title company on the issuance of this guaranty, counsel sets up lines of communication that make it easier to obtain title insurance from that company on successful completion of the litigation.

The importance of actually purchasing a litigation guaranty is illustrated by *Little v Community Bank* (1991) 234 CA3d 355, 286 CR 4, in which a judgment creditor relied on a preliminary report to make a motion to sell a judgment debtor's residence under CCP §§704.710-704.850. The preliminary report, and hence the creditor's motion, failed to disclose the existence of several IRS tax liens on the property. A third party bought the property at the sale, and thereafter was forced to pay the tax liens on the property. The third party subsequently won an award against the judgment creditor for its failure to disclose the tax liens because the motion did not comply with the requirement of CCP §704.760, requiring the listing of all liens and encumbrances. See also §§5.26-5.29 regarding nonliability of title insurance company for preliminary reports.

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§9.10 2. Purpose of Litigation Must Be Accurately Described

An appropriate litigation guaranty can be issued only when counsel has accurately described to the issuer the purpose for which the guaranty is desired. This is in contrast to other guaranties that internally describe their purpose (*e.g.,* to show judgments and tax liens of record against a named individual). The litigation guaranty states that it "is furnished solely to facilitate the filing of an action to _____." This blank must be completed accurately to reflect the purpose of the proposed action. The information the issuer will show in the litigation guaranty will be very different, depending on the purpose specified.

EXAMPLE: If counsel for a beneficiary under a recorded deed of trust seeks a litigation guaranty for a judicial foreclosure action, the guaranty will show matters recorded against the encumbered property after the date of recording of the deed of trust. If counsel for a property owner seeks a litigation guaranty for an action to quiet title to an easement, the guaranty will list only vested owners and interest holders on the servient estates; it will not show encumbrances on the dominant tenement.

Clients sometimes wish to proceed with a nonjudicial foreclosure without purchasing a trustee's sale guaranty or to proceed with a judicial foreclosure without a litigation guaranty. The clients may be concerned about expenses in general, or they may believe that reinstatement of the loan or settlement of the litigation is so likely that the expense is unwarranted. Because both actions require notice to specified parties, and thus significant potential liability arises if a party is inadvertently omitted, counsel should not propose this course of action and should carefully advise the client of the risks if they wish to proceed without the appropriate guaranty. Similarly, title companies should provide the list of specified parties only through their promulgated guaranties.

PRACTICE TIP: Counsel should memorialize the discussion of the objective of the title-related issues in the contemplated litigation with the issuer. When the litigation guaranty is issued, the purpose line of Schedule A should be checked carefully for accuracy.

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§9.11 3. Establishing Amount of Liability

Probably the most accurate method for establishing the amount of liability for the litigation guaranty is to make a reasonable estimate of the fees and costs that might be incurred to litigate against an overlooked party. This method should result in liability coverage that is sufficient to cover actual damages but that is not excessive, thereby avoiding unnecessary premiums costs. Generally, the premiums charged for the litigation guaranty are the same or similar as premiums charged for a standard owner's policy.

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§9.12 4. Assurances Given

The litigation guaranty provides assurances on:

- The name of the vested owner of the property;
- Defects, liens, encumbrances, or other matters affecting title to the interest, except as shown;
- The names of the current interest holders found of record who claim some right, title, or interest and whom, together with the vestee, it may be necessary to name in the action described; and
- The return addresses for mailing shown on the recorded documents for the interest holders and the vestee.

The list of interest holders of record who might claim some right, title, or interest is divided into two parts and set forth in Schedule B, Parts I and II. Schedule B, Part I lists interest holders that counsel usually does not name in the type of action described in the guaranty. For instance, in a judicial foreclosure action on a deed of trust, CC&Rs and easements recorded prior to the deed of trust would usually be placed in Schedule B, Part I. The current holders of those interests are not ascertained (*e.g.*, subsequent owners of the dominant tenement of an easement), and return mailing addresses are not shown.

Schedule B, Part II lists the current interest holders claiming some right, title, or interest whom counsel would usually name in the type of action described in the guaranty. An action to quiet title to an easement, for instance, would probably name the vested owners of the servient properties as well as any deed of trust beneficiaries and lien claimants on the servient properties that the dominant easement claimant alleges to be junior to the easement. In addition, the return mailing addresses of interest holders shown in Schedule B, Part II and in the documents vesting title in Schedule A are included in Schedule C.

Counsel should review Schedule B, Part I carefully to ensure that no interest holders are shown who should be included in the litigation. An example is a deed of trust that was recorded first but that was subordinated by an off-record agreement to the foreclosing deed of trust. In that event, counsel should request that the item be moved from Part I to Part II, which will result in the issuer's doing a further search on the item to learn the current interest holder of record (*e.g.*, the current beneficiary by assignment) and to list the return mailing address shown on the recorded document for the current interest holder.

PRACTICE TIP: Counsel should request copies of the documents referred to in Schedule B, Part II. These documents contain valuable information (*e.g.*, addresses of relevant parties), whereas the guaranty includes only a mailing list based on the return addresses, if any, shown in the upper left corner of the recorded document.

The litigation guaranty does not come with a witness. Counsel can often get the litigation guaranty itself introduced into evidence without a witness either by stipulation of the parties or as a business record under *Talbott v Wake* (1977) 74 CA3d 428, 443, 141 CR 463. If counsel needs a title witness, arrangements separate from the litigation guaranty must be made. Retired title officers can be good expert witnesses. For an additional cost, the title company issuing the guaranty may be willing to allow a title officer to be retained as an expert witness.

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C. Lot Book Guaranty

§9.13 1. Purpose

As discussed in §4.10, title companies rearrange recorded documents in a title plant in order to make them more easily accessible. The lot book guaranty is unusual because it offers assurances based strictly on the title plant records maintained by the issuer. Thus, if the issuer failed to properly post a recorded document in its title plant, it would have no liability for that error under this guaranty.

The lot book guaranty gives assurance, based on the issuer's title plant records, on the last deed purporting to transfer title, and mortgages and deeds of trust purporting to affect title, but it does not provide assurances on the priority of any listed deeds of trust. Accordingly, counsel should be very careful about recommending this guaranty and should thoroughly explain its limitations to a client interested in purchasing it.

Lot book guaranties are often purchased by lenders making second deed of trust loans or by parties desiring a quick read on the property. A lender making a second loan needs title information but sometimes, for competitive reasons, may not be able to charge the borrower for a full title policy (*e.g.*, an institutional lender making an equity loan on residential property). Therefore, it may purchase a lot book guaranty. Often such a lender also purchases a judgment and tax lien guaranty (see §9.21) in order to obtain a search of the name index maintained by the issuer in addition to the title plant information. The issuance of these two guaranties together is known as a "combination guaranty." This method of obtaining limited title protection at a lower cost is largely being supplanted for institutional secondary lenders by their purchase of a limited coverage policy. See §§9.22-9.23.

The lot book guaranty is a method for a prospective bidder at a property auction to obtain information on senior mortgages and deeds of trust, although serious risks are associated with its use, which must be fully understood. The principal risk is that the information is limited to the issuer's title plant. Despite this limitation, it can sometimes be useful.

EXAMPLE: A prospective bidder at an auction may purchase a lot book guaranty to obtain information on senior encumbrances. Even though the loss could be large because bidding was too high as a result of the guaranty's failure to disclose a senior deed of trust, the bidder must weigh that risk against the need to obtain the information at a reasonable price because of the many auctions that must be attended in the process of becoming the successful bidder on a few.

The lot book guaranty can also be used to request a search of the title plant for specific documents posted to the property, such as homesteads, attachments, notices of nonresponsibility, or notices of completion.

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§9.14 2. Assurances Given

The assurances given by the lot book guaranty are that, according to the issuer's property records, relative to the subject land (but not including any records maintained by name rather than by property):

- The recording information for the last recorded instrument purporting to transfer title is shown;
- The mortgages and deeds of trust purporting to affect title are shown; and
- Specific documents as requested by the assured, such as homesteads or notices of completion, are shown.

The last assurance, on specifically requested documents, can be useful for a creditor who wants to know whether a title company's plant shows a homestead recorded on the property or for a mechanics' lien claimant who wants to know whether the plant shows a recorded notice of completion that had a deadline for recording a mechanics' lien.

CAVEAT: Note that, even for documents found in the title plant and shown in the guaranty, no assurance is given on the validity of any document.

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§9.15 3. Limitations

The limited coverage, and therefore limited value, of this guaranty was highlighted in *Harrison v Commonwealth Title Ins. Co.* (1979) 97 CA3d 973, 159 CR 209. The plaintiff alleged that he purchased property at a sheriff's execution sale, relying on a lot book guaranty that was issued to the attorney for the judgment creditor who caused the execution sale to be held. The guaranty did not disclose a senior deed of trust. The liability amount shown on the guaranty was $100. While acknowledging that he was not named as an assured, the plaintiff argued that he was a "foreseeable plaintiff" whom the title company knew would justifiably rely on the guaranty. The appellate court upheld the trial court's sustaining of a demurrer on the basis of the explicit terms of the guaranty. The court noted that the guaranty (97 CA3d at 975):

> had a maximum stated liability of $100 only to the named insured, and was based solely and explicitly on the title company's lot book records. The guaranty explicitly stated that its grantor-grantee indexes had not been examined, and it made no representation as to the state of the official public records.

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D. Recorded Document Guaranty

§9.16 1. Purpose

Environmental contamination is a major concern in real estate transactions. Prospective lenders and purchasers seeking to use the safe harbor, or "innocent landowner," provisions of the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) (42 USC §§9607(b)(3)) need the title history to assist in finding any contamination on the property. Title companies, however, are fearful of liability for the clean-up costs of contaminated property, which can be far greater than reserves established for title losses. (For discussion of the scope of coverage under a title policy in the context of a contaminated property and the distinction between "marketable title" and "market value," see *Lick Mill Creek Apartments v Chicago Title Ins. Co.* (1991) 231 CA3d 1654, 1660, 283 CR 231.) On title insurance coverage for environmental protection liens, see §§6.86, 7.19. For further discussion of the innocent landowner defense, see California Real Property Sales Transactions, chap 7 (4th ed Cal CEB 2007). For further discussion of CERCLA (42 USC §§9601-9675), see California Real Estate Finance Practice: Strategies and Forms §4.66 (Cal CEB 2000).

The title industry has standardized provisions of title products through the California Land Title Association (CLTA) and the American Land Title Association (ALTA), which develop and publish the most widely used forms. In response to customers' needs for title history in this context, while being careful to circumscribe the issuer's liability in such matters, the CLTA has filed with the California Department of Insurance the recorded document guaranty. An application for issuance must be signed by the customer and typically sets a maximum liability of $10,000. The application provides that coverage is payable only if clean-up costs or penalties are actually imposed solely because of an error in the guaranty. Moreover, the error must have caused the applicant to fail to comply with the due-diligence requirements in connection with the innocent landowner or purchaser defenses under CERCLA. Attorney fees and costs in any claim against the applicant are excluded from coverage under the guaranty. Thus, the title history needed for a CERCLA safe harbor investigation can be obtained from a title company, but only if the applicant agrees to a limited dollar liability on a limited basis. The recorded document guaranty provides a valuable paper trail to show the client's compliance with CERCLA's "innocent purchaser" requirements.

PRACTICE TIP: The applicant must check one or both of two options on the records to be searched: The company's title plant records or the county recorder's records (grantor/grantee indexes). If the cost is not excessive, it makes sense to choose both.

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§9.17 2. Scope

The applicant must choose the number of years the guaranty should cover. The standard number ranges from 30 to 50 years, with 40 being the most common.

The applicant must also choose which documents the title company will reflect in the guaranty. The documents so designated are copied and attached to the guaranty. The choices are:

- Deeds;
- Leases and subleases;
- Mortgages/deeds of trust;
- Environmental protection liens recorded under CERCLA; and
- All documents

PRACTICE TIP: Unless the applicant's environmental consultant indicates a need for only some of the options, the applicant should take the "All documents" option. (The consultant is normally the one who will use the guaranty's information to assist in evaluating the property.) Choosing fewer than all might result in an omission of important information that one of the omitted categories might have disclosed.

The resulting guaranty simply lists the designated documents and attaches copies of them. It is up to the applicant to evaluate them for any indication they might give of possible contamination. A lease to a well-known petroleum company is an easy lead, but a lease to an unknown corporation can be much more difficult to evaluate.

PRACTICE TIP: The fee for this guaranty can be reduced if the guaranty is issued in conjunction with an open order for title insurance and if the title policy is subsequently issued.

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§9.18 E. Chain of Title Guaranty

Counsel investigating the history of title on property to evaluate a current issue should obtain a chain of title guaranty in order to have all the recorded documents that impart constructive notice on the matter. For example, a chain of title might disclose a prior common ownership of two properties in which the owners are now disputing an easement. The prior common ownership could be crucial in establishing an easement by implication or necessity. Often, surveyors obtain chain of title guaranties to obtain the history of the legal descriptions of the property.

Although the chain of title and recorded document guaranties can contain the same information, title companies will not issue the former in connection with a CERCLA (Comprehensive Environmental Response, Compensation and Liability Act of 1980) due-diligence investigation (if they are aware that that is the purpose of the guaranty), because of the clean-up expenses. Only the recorded document guaranty is available for that purpose. See §9.16.

PRACTICE TIP: The chain of title guaranty requires the applicant to choose a date from which the chain of title information will come forward. Rather than choosing an arbitrary date, counsel should try to find a starting document, such as the deed placing the two properties in common ownership in the above example.

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§9.19 F. Mechanics' Lien Guaranty

Counsel representing a mechanics' lien claimant on a troubled project needs to know the recordation dates of such items as notices of completion, notices of cessation of labor, and notices of nonresponsibility, which will enable counsel to calendar deadlines and evaluate available causes of action and possible defendants. For instance, a claimant on work contracted for by a tenant will not have a mechanics' lien cause of action against the landlord if a notice of nonresponsibility was timely recorded.

Counsel must also ascertain whether other mechanics' lien claims were filed against the property and whether the claimants have filed actions to foreclose. This information will help counsel to evaluate the total dollar amounts claimed against the property and to name other lien claimants as defendants in the action. On mechanics' liens generally, see California Mechanics' Liens and Related Construction Remedies (3d ed Cal CEB 1998).

The mechanics' lien guaranty provides all the above information.

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§9.20 G. Property Search Guaranty

This guaranty establishes ownership of real property in the designated name according to the latest assessment roll and the indexes of the county recorder. It can also be used to learn of any mortgages and deeds of trust acquired in the designated name or names and not later assigned, released, or reconveyed. This information can be vital for a creditor seeking assets held by a debtor.

This guaranty is also used to find property to be included in probates.

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§9.21 H. Other Guaranties

About 20 guaranties are currently available. Among the other available guaranties are:

- **Judgment and Tax Lien Guaranty**—discloses judgment and state tax liens contained in the county recorder's indexes against a certain named person.
- **Mining Claim Certificate Guaranty**—discloses the present vesting of a described mining claim as shown in the indexes of the county recorder's office.
- **Notice of Award Guaranty**—discloses any special assessments or bonds on the property and any recorded notices of contract awards relating to the same.
- **Parcel Map Guaranty**—provides the county or city in which the land is located with assurances of the name of the vested owner of the property and of the sufficiency of the parcel map for use as a primary reference for legal descriptions of the parcels shown on the map.
- **Patent Mineral Reservation Guaranty**—discloses mineral reservations in patents, or the acts authorizing the issuance of patents, on the specified property.
- **Personal Property Encumbrance Guaranty**—discloses financing statements, etc., recorded in the county recorder's office against specified personal property.
- **Plant Information Guaranty**—discloses any instruments describing the subject property found in the title plant after a certain date.
- **Property Owner's Notice Guaranty**—lists, for purposes of providing notice of a permit application, the assessed owners who own property within a specified number of feet of a given piece of property.
- **Record Owner Guaranty**—shows the last instrument in the title plant purporting to transfer title to the land.
- **Recorder's Index Guaranty**—discloses documents to be specified, indexed under specified names that are shown in the grantor and grantee indexes of the county recorder's office, from a specified date to the present.
- **Subdivision Guaranty**—provides the county recorder with lists of parties of record whose signatures are necessary to consent to the recordation of a subdivision map.

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IV. LIMITED COVERAGE POLICIES

§9.22 A. Purpose

Home equity loans secured by second deeds of trust on a borrower's home have become very popular. These loans can involve either fixed amounts or revolving credit. The lender needs some title assurance but often is not able to pass on much, if any, of the cost to the borrower because of the fierce competition in this market. Also, some lenders believe that their risk is less because of the small size of a home equity loan and because the property is already owned by the borrower, who frequently obtained title insurance when the property was acquired. Therefore, lenders may elect to accept less title assurance than a title policy would provide. Both title insurers and lenders cap the loan amount that may be insured by these limited coverage policies. This cap varies but is typically in the $100,000-$200,000 range.

Lenders in the past often used a "combination guaranty" (consisting of a lot book guaranty and a judgment and tax lien guaranty) in this context. See §9.13. Over time, the limited coverage policy became the accepted vehicle. It is typically priced in the same $100 range as the combined guaranty and offers similar assurances but is more in the style of a title policy. This type of policy represents a recent trend in the title insurance business insofar as it represents more of a "data information sheet" rather than a traditional form of title insurance.

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§9.23 B. Scope

Historically, neither the CLTA nor the ALTA adopted a standard form of limited coverage policy. Each title company issued its own form, requiring counsel to examine each policy for specific language and coverage. Recently, however, the ALTA adopted a standard form residential limited coverage junior loan policy and accompanying endorsements. The CLTA in turn adopted the ALTA form for use in California.

In general, a limited coverage policy lists the last document purporting to vest a fee estate in the land and states the name or names of the purported vestees shown in that document. Note that the issuer does not provide coverage against someone else's claiming title unless the claim arises from a document recorded after the document referred to in the limited coverage policy. This situation is in stark contrast to a title policy that insures against loss because of title "being vested other than as stated." In a limited coverage policy, the issuer's only liability in this regard is if it failed to reflect the last document of record purporting to vest title or if it improperly recited the vestees as shown on that last document. Thus, any failure in the vesting anywhere in the chain of title (*e.g.*, as a result of fraud, forgery, or incapacity), including the last document referred to in the policy, would not be a covered loss. This coverage is similar to the lot book guaranty, but it is not limited to the records in the issuer's title plant and does cover the public records.

The limited coverage policy provides coverage against any recorded lien or mortgage against the land unless shown as an exception. The mortgage protection is similar to the lot book guaranty though, again, it is not limited to the issuer's title plant information.

The protection against liens is similar to the assurance provided by the judgment and the tax lien guaranty.

PRACTICE TIP: Although the limited coverage policy is useful to a sophisticated lender in a situation in which it elects to use limited title assurances, counsel should be cautious about recommending it to anyone else. The warnings in *Harrison v Commonwealth Title Ins. Co.* (1979) 97 CA3d 973, 159 CR 209 (see §9.7) generally apply here as well.

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10

Title Instructions and Issuance of Title Insurance Policy

Marjorie Floyd Burchett

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§10.1 I. INTRODUCTION; SCOPE OF CHAPTER

The issuance of the title insurance policy is the culmination of a process that includes a title search and examination, review by counsel and clients of the condition of title, and determination of the type of title insurance to be obtained. Typically, a title insurance policy is issued concurrently with a real property transaction's closing. However, a title insurance policy may also be issued to a party who wants to insure an existing interest in real property in the absence of a transaction. In either event, it is vital that the parties follow the appropriate procedures and that the prospective insured accurately describes the desired kind of title policy to be issued by the title insurer.

This chapter explores the roles of the various parties to the transaction, suggests a manner for obtaining the title policy, and describes certain considerations related to the issuance of the title policy. This chapter does not, however, focus on the duties or obligations of escrow agents or on escrow instructions generally. On escrow agents and related issues generally, see California Real Property Sales Transactions, chap 15 (4th ed Cal CEB 2007).

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§10.2 II. ROLE OF ESCROW AGENT AND TITLE OFFICER

Escrow agents and title officers may both be involved in issuing a title insurance policy. Depending on the location of the transaction (Northern or Southern California), the escrow agent and the title officer may work for the same company or different companies. On the role of escrow agents generally, see California Real Property Sales Transactions, chap 15 (4th ed Cal CEB 2007). On title officers, see §§2.12, 2.19.

Most real estate transactions involve an escrow because it allows lenders and buyers to control funds until all conditions are met and the title company is prepared to issue a title policy. Title companies generally require escrows as a means of controlling recordation of documents.

PRACTICE TIP: Few escrow officers are lawyers. Working through title and document recording questions and problems with the escrow officer requires practical problem-solving abilities and persuasion more than fine legal arguments. Thinking of alternative and creative ways of solving problems identified by the escrow officer is usually more successful than trying to convince the officer that the problem does not exist or is not legally significant.

Well before closing, the lender or buyer should inform the escrow agent or title officer what coverage will be required, including which exceptions must be deleted before closing. On negotiating coverage, see §§2.22-2.29; on negotiating exceptions to coverage, see §§5.21-5.24. All documents necessary for closing (*e.g.,* new easements, boundary agreements, deeds) should be provided as early as possible for the title officer's review to make sure that they are in recordable form and that all necessary authorizations were received. On authorization documents, see §§2.29-2.34.

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§10.3 A. Escrow Closings

Escrows are commonly used in California for real estate closings. In Northern California, the escrow agent and title officer are generally part of the same title company. In Southern California, the escrow agent is traditionally with an independent escrow company. In this event, the agent generally is primarily responsible for obtaining the required title insurance. The insured, of course, should approve the title insurance company to be used. On selecting title insurance companies generally, see chap 3; on the differences between Northern and Southern California escrows, see §3.30; California Real Property Sales Transactions, chap 15 (4th ed Cal CEB 2007).

NOTE: Although independent escrow agents are still a presence in Southern California, many such agents have been acquired by title insurance companies. When that has occurred, escrow will be handled similarly to a Northern California closing.

In obtaining insurance, the escrow agent is bound to follow the written instructions of the insured, which will describe the type and amount of coverage desired and the acceptable exceptions to coverage. On claims against escrow companies for failure to follow instructions, see §11.47.

PRACTICE TIP: If an underwritten title company is an escrow agent, counsel should consider using a closing protection letter. On such letters, see §§3.5, 10.7. Lenders generally use subescrows in which the title insurance company controls the funds while the escrow agent handles administrative matters. On subescrows, see §§1.11-1.12, 3.30.

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§10.4 B. New York-Style Closings

In a "New York-style" closing (also called a "table" closing) an escrow is not used in the transaction. Instead, the parties meet in person at a closing meeting with a representative of the title insurer. The parties do not use a third party escrow agent to hold or move funds during the transaction. The insurer commits to issue its policy at the time of closing. Because there is a gap between the time of the New York-style closing and the recordation of the documents, the title insurer generally requires a "gap indemnity" from the seller or borrower before agreeing to issue the title policy as of the closing date.

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§10.5 C. Instructions on Coverage

To clearly delineate the title coverage to be issued, counsel should submit written instructions to the escrow agent or title officer, setting forth the coverage requirements. The instructions direct the escrow agent or title officer to confirm, either in writing or verbally, that the title insurer is unconditionally committed to issue the title coverage requested before the close of escrow. The instructions also direct the escrow agent on such other matters as the handling of funds and recordation of documents related to the transaction. Counsel must be certain that the escrow instructions and any modifications to them are consistent with the purchase and sale agreement or loan agreement and any modifications to those documents. These instructions may be treated somewhat differently, depending on the type of the transaction. Title policy instructions for purchase and sale transactions and loan transactions are discussed in §§10.13-10.17. On escrow instructions generally, see California Real Property Sales Transactions, chap 15 (4th ed Cal CEB 2007).

PRACTICE TIP: Although oral instructions may be given (see *Zang v Northwestern Title Co.* (1982) 135 CA3d 159, 185 CR 176), the better practice is to provide written instructions because they simplify proof of the instructions. They help the escrow company confirm that instructions from all parties are consistent. If for any reason written instructions cannot be used, the next best course of action is to mark up a preliminary report or commitment to show the desired changes and follow it with written instructions. Finally, if oral instructions are used, they too should be followed by confirming written instructions.

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III. ROLE OF ATTORNEY

§10.6 A. Advise on Coverage

The attorney's role in obtaining the appropriate coverage at closing is usually to inform the title company of the coverage to be obtained and to negotiate the terms and conditions of this coverage before close of escrow. It is always preferable to describe the required policy in writing or, if all negotiations have been verbal, to obtain a pro forma policy in the form requested before closing. See §10.11.

Many of these negotiations may have occurred during the attorney's review of the preliminary report, but often the parties do not focus on the details of the coverage itself, such as deleting undesirable policy terms or adding endorsements, until just before closing. Waiting too long to address these issues can raise significant problems that cannot be solved at the last minute. It is best to complete the analysis early in the transaction and provide the insurer with a list of the client's specific policy requirements. Many purchase and sale contracts require this analysis to be completed within a specific period of time. On negotiating coverage, see §2.22-2.27; on negotiating title exceptions, see §§5.21-5.24.

It is important that attorneys advise clients about the full range of available title coverage and, particularly if representing institutional clients, clearly understand any special requirements of their client. To do so, counsel must have a good understanding of the available coverages. See chaps 6-8 for discussion of coverages available.

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§10.7 B. Advise on Coinsurance, Reinsurance, and Closing Protection Letters

Counsel should confirm early in the transaction that the insurer either is committed to issue the title policy or has the ability to do so and the financial capacity to pay losses under the policy if a claim is made. On insurer's financial stability, see §3.7. If an underwritten title company is issuing the policy, counsel should consider using a closing protection letter to confirm the underlying insurer's liability for the acts of its underwritten title company agent, including the handling of closing funds. See §3.5.

In addition, if there is any doubt about the title insurer's financial strength and ability to pay claims up to the liability amount of the policy, counsel should discuss with the client the use of coinsurance or reinsurance before close of escrow. On coinsurance and reinsurance, see §§3.8-3.14; on title instructions dealing with coinsurance and reinsurance, see §10.17. Institutional clients often establish their own requirements about these matters, of which the attorney should be aware.

PRACTICE TIP: Coinsurance and reinsurance should be raised with the insurer as soon as possible after opening escrow. Obtaining coinsurance or reinsurance frequently delays a transaction, especially if difficult underwriting issues are raised that must be resolved to the satisfaction of both the companies and the insured. There are also additional cost issues to consider.

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Source: Real Property/California Title Insurance Practice/10 Title Instructions and Issuance of Title Insurance Policy/ §10.8 C. Verify Ability/Commitment to Issue Coverage

§10.8 C. Verify Ability/Commitment to Issue Coverage

Counsel must confirm the title insurer's ability to issue the coverage requested. The different methods of doing so provide varying degrees of assurances that the title company will issue the desired coverage.

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§10.9 1. Verification of Instructions

The most straightforward manner of obtaining verification is to have an authorized officer of the title company execute and return before closing a copy of the instructions, which describe the desired coverage. In Northern California, the instructions are typically part of the escrow instructions submitted shortly before closing. In Southern California, where the initial escrow instructions are often prepared at the beginning of a transaction and, therefore, do not include specifics of title coverage, the instructions will be in a separate title insurance instruction letter. See §§10.13-10.17.

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§10.10 2. Commitments

A title commitment may also be used to confirm the title company's agreement to issue a specified title policy subject only to the exceptions listed in the commitment. When a commitment is used, it is good practice to obtain a specimen policy (commonly known as a pro forma; see §10.11) to confirm the exact wording of the coverage to be issued. For further discussion of title commitments and the liability of title insurers regarding those commitments, see §§5.31, 5.38.

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§10.11 3. Pro Formas

A pro forma or "specimen" title policy, obtained before closing, is an actual form of the title policy to be issued at the closing. It gives the insured an opportunity to confirm word for word what the coverage will be and to more easily request specific modifications to the coverage to be issued. If a pro forma title policy is used, the title insurer may agree to provide a letter confirming its ability on recording to issue coverage in the form agreed on in advance, subject to any new matters recorded after the date of the pro forma and before the closing date. An example of instruction language that could be used when a pro forma or specimen title policy is being attached to the insured's instructions in a loan transaction is in §10.12.

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§10.12 4. Form: Pro Forma Closing Instruction

10.12-1 Pro forma closing instruction

As a condition to the closing, Title Company will issue _ _[*an ALTA Lender's Extended Coverage/a CLTA Standard Coverage*]**_ _ Policy of Title Insurance (_ _**[*insert year of the policy form*]**_ _ Form) (Title Policy), dated the date and time of the later of either recording the Deed of Trust or funding of the Loan, insuring Lender in the amount of $_ _**[*amount*]**_ _ as the holder of record of a first deed of trust on the subject property, showing fee title vested in Borrower. The Title Policy shall be identical to the Pro Forma Policy attached to this document as Exhibit A in all respects, including (i) the state of title, (ii) the matters set forth in Schedule B, (iii) the coverage and affirmative insurance with the stated additions and revisions, and (iv) the attached endorsements.**

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D. Prepare Title Policy Instructions

§10.13 1. Purchase and Sale Transaction

Practices differ in Northern and Southern California on using escrow and title instructions. In Northern California, the escrow agent does not usually receive a copy of the purchase and sale agreement. Although preprinted title company form escrow instructions are common in residential closings, in commercial transactions counsel typically prepares a detailed set of escrow instructions, which are provided to the escrow company late in the transaction, near the time of closing, and include detailed information on the type of title coverage to be issued, including language substantially the same as the instructions in §10.15. Many such instructions are unilateral instructions.

In Southern California, the purchase agreement is usually provided to the escrow company, which prepares escrow instructions when the escrow is opened. These instructions are generally mutual instructions, signed by all parties to the transaction, and do not deal with title insurance matters. Separate title instructions, signed only by the prospective insured, are often prepared by counsel and delivered to the escrow company near the closing. See §§10.15, 10.17. Escrow companies may not accept escrow instructions in a purchase agreement and will insist on the parties' executing separate instructions.

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§10.14 a. Supplemental Title Instructions

In a purchase and sale transaction, as a rule, the general escrow instructions, the purchase and sales contract, or both address the various aspects of the closing of the transaction. Although the instructions sometimes include all the information that the escrow agent or title company need to obtain or issue the appropriate coverage, supplemental title instructions are often necessary to set forth the specifics of the coverage. This task can be handled by a brief letter of instruction prepared by the insured's attorney such as the form in §10.15.

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Source: Real Property/California Title Insurance Practice/10 Title Instructions and Issuance of Title Insurance Policy/ §10.15 b. Form: Letter of Instructions for Purchase and Sale

§10.15 b. Form: Letter of Instructions for Purchase and Sale

_ _[*Name and address of escrow agent*]_ _

Re: Escrow No. _ _ _ _ _ _/Title Order No. _ _ _ _ _ _

_ _[*Identify transaction, e.g., Smith/Jones Acquisition*]_ _

Dear _ _[*name of escrow agent*]_ _:

This letter serves as supplemental instructions to the escrow referred to above concerning the issuance of title insurance to _ _[*name of buyer*]_ _ (Buyer) in the transaction identified above.

As used in this letter, "Preliminary Report" refers to the Preliminary Report dated _ _[*date*]_ _, issued by _ _[*name of title insurance company*]_ _ Title Insurance Company (Title Company), regarding Title Order No. _ _ _ _ _ _ referred to above.

[*Add if preliminary report is supplemented*]

as supplemented by the Supplemental Report issued by Title Company dated _ _[*date of Supplemental Report*]_ _.

[*Continue*]

As used in this letter, "Title Policy" refers to _ _[*an ALTA Owner's Extended Coverage/a CLTA Standard Coverage*]_ _ Policy of Title Insurance (_ _[*insert year of policy form, e.g., 1970-B*]_ _ Form)

[*Add if endorsements were used*]

and CLTA Endorsement Nos. _ _[*endorsement numbers*]_ _,

[*Continue*]

insuring that _ _[*describe title insured, e.g., fee*]_ _ title to the subject property is vested in Buyer, subject only to Exception Nos. _ _[*list all typed exceptions to appear in Part II, Schedule B of the title policy, including lien for current taxes and exceptions shown on preliminary report that are acceptable to buyer*]_ _ as shown on the Preliminary Report and to _ _[*add any deeds of trust or other instruments or encumbrances being recorded at close of escrow*]_ _, with coverage in the amount of $_ _[*amount*]_ _.

Please advise the undersigned when the Title Company is unconditionally committed to issue the Title Policy. You are to record the document(s) to be recorded in this transaction *when and only when* Title Company is unconditionally committed to issue the Title Policy and you have received my confirmation by telephone that you may record these documents.

If you have any questions or need clarification regarding the documents described above or these instructions, please contact me. If the foregoing is acceptable to Title Company, please so indicate by executing the enclosed counterpart of this letter and returning it to the undersigned by _ _[*identify acceptable method of communication, e.g., telecopier, overnight mail, regular mail*]_ _.

Sincerely,

__[*Signature*]__
_ _[*Typed name*]_ _
Attorney for Buyer

Date: _ _ _ _ _ _

AGREED AND ACCEPTED:
_ _[*Name of title company*]_ _

By: __[*Signature*]__
Name: _ _[*Typed name*]_ _
Its: _ _[*Title*]_ _

Comment: This letter of instructions deals only with title issues at closing. For a sample of a full set of escrow instructions, see California Real Property Sales Transactions, chap 15 (4th ed Cal CEB 2007).

PRACTICE TIP: Sometimes an escrow company will accept escrow instructions only from the parties and not from their attorneys, although this is generally not true of instructions like the foregoing, which deal only with title matters. Counsel should ascertain in advance whether the client's signature is needed for any set of instructions. If so, the instructions can include a statement that the attorney can sign all future modifications and supplements.

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2. Loan Transactions

§10.16 a. Issuance of Lender's Policy

In both Northern and Southern California, written instructions on the issuance of a title policy in a loan transaction frequently address all matters to be handled by the title and/or escrow company related to the loan transaction. These matters may include funding the loan, payment of liens and encumbrances, payment of fees and costs from loan proceeds, recordation of loan documents, and delivery of documents after closing. The instructions typically act as the transmittal letter to the title insurer enclosing the documents to be recorded on closing. The matters of concern to a lender in connection with a lender's policy of title insurance are addressed in the form instructions in §10.17.

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Source: Real Property/California Title Insurance Practice/10 Title Instructions and Issuance of Title Insurance Policy/ §10.17 b. Form: Letter of Instructions for Loan

§10.17 b. Form: Letter of Instructions for Loan

_ _[*Name and address of escrow agent*]_ _

Re: Escrow No. _ _ _ _ _ _/Title Order No. _ _ _ _ _ _

_ _[*Identify transaction, e.g., Smith/Jones Acquisition*]_ _

Dear _ _[*name of escrow agent*]_ _:

This letter serves as closing instructions in the transaction named above regarding the issuance of title insurance to _ _[*name of lender*]_ _ (Lender) on a _ _[*dollar amount*]_ _ loan (Loan) to be made by Lender to _ _[*name of borrower*]_ _ (Borrower).

Enclosed are executed originals of the following documents (Recordation Documents):

[*List documents to be recorded, in the order to be recorded*]

1. _ _[*e.g., Deed of Trust*]_ _,

2. _ _[*e.g., Assignment of Leases and Rents*]_ _, *and*

3. _ _[*List any other loan documents Title Company is to record*]_ _.

As used in this letter, "Preliminary Report" refers to the Preliminary Report dated _ _[*date*]_ _, issued by _ _[*name of title insurance company*]_ _ Title Insurance Company (Title Company) regarding Title Order No. _ _ _ _ _ _, referred to above.

[*Add if Preliminary Report is supplemented*]

as supplemented by that certain Supplemental Report issued by Title Company dated _ _[*date of supplement*]_ _.

[*Continue*]

As used in this letter, "Title Policy" refers to _ _[*an ALTA Lender's Extended Coverage/a CLTA Standard Coverage*]_ _ Policy of Title Insurance (_ _[*insert year of the policy, e.g., 1970*]_ _ Form)

[*Add if endorsements were used*]

and CLTA Endorsement Nos. _ _[*endorsement numbers*]_ _,

[*Continue*]

and an endorsement deleting the "Creditor's Rights" exceptions from the Title Policy, issued in favor of Lender, showing title as vested in Borrower, insuring the lien of the Deed of Trust as a first lien on the property described in the endorsement, subject only to Exception Nos. _ _[*list all typed exceptions to appear in Part II, Schedule B of the title policy, including lien for current taxes and exceptions shown on preliminary report that are acceptable to lender*]_ _ as shown on the Preliminary Report, with coverage in the amount of the Loan.

[*Address any coinsurance or reinsurance requirements and the handling of loan proceeds, if applicable; see following paragraphs for examples*]

[*Add if coinsurance required for closing*]

You are further instructed not to record the Recordation Documents until you have received confirmation that _ _[*name of coinsurer*]_ _ is unconditionally committed to issue its title policy in favor of the insured.

[*Add if reinsurance required for closing*]

Before closing, you must confirm with the undersigned that you have executed that certain _ _[*describe reinsurance agreement*]**_ _ with _ _**[*name of reinsurer*]**_ _.**

[*Continue*]

Please advise me when Title Company is prepared, on recordation of the Recordation Documents in the order indicated, to issue the Title Policy and has received funds from Borrower sufficient to make all disbursements set forth below. Do not record any documents until you have received authorization from me. _ _[*Identify party to pay costs*]**_ _ shall pay _ _**[*all/or, if costs are to be divided, list costs each party is responsible to pay*]**_ _ costs associated with the issuance of the Title Policy.**

If you have any questions or need clarification regarding the documents described above or these instructions, please contact me. If the foregoing is acceptable to Title Company, please so indicate by executing the enclosed counterpart of this letter and returning it to the undersigned by _ _[*identify acceptable method of communication, e.g., telecopier, overnight mail, regular mail*]**_ _.**

__[*Signature*]__
_ _[*Typed name*]_ _
Attorney for Lender

Title Company:

AGREED AND ACCEPTED:

Date: _ _ _ _ _ _

By: __[*Signature of escrow agent*]__
Name: _ _[*Typed name*]_ _
Its: _ _[*Title*]_ _

Borrower:

AGREED AND ACCEPTED:

Date: _ _ _ _ _ _

__[*Signature of borrower*]__
_ _[*Typed name*]_ _

Comment: It is a good idea to have the borrower sign a copy of these instructions to obtain written confirmation that the borrower approves the instructions regarding disbursement of funds. For a form of a lender's printed form escrow instructions, see California Real Property Sales Transactions, chap 15 (4th ed Cal CEB 2007).

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§10.18 3. Premium Payments

Depending on the insured's financial strength, title insurers often require that the premium for the title policy be paid from the closing proceeds. Frequently, this premium is paid from the seller's proceeds in a purchase and sale transaction or from the borrower's in a loan transaction. Any letters of instruction delivered to the title insurer, such as those discussed in §§10.13-10.17, should specify the party who is to pay the premiums.

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§10.19 E. Certify That Requirements Satisfied

Many institutional clients (particularly those on the East Coast, who are not accustomed to dealing with escrow companies) require attorneys to certify that the client's requirements have been satisfied or will be satisfied at the closing. Such clients rely more on this certification than on a written acknowledgment from an escrow agent or a title company.

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F. Review Title Insurance Policy Issued

§10.20 1. Correct Mistakes in Policy

One of counsel's most important tasks in a transaction is to review the actual title policy issued, because it is commonly delivered up to a month after the closing. Counsel for the insured should review the title policy for complete conformance with the instructions given to the insurer (and conformance with any commitment or pro forma issued to the insured), including checking the vesting, legal description, exceptions to title listed, and all endorsements attached. Title companies are normally very cooperative in correcting defects in the title policy, but it is vital that clear written instructions on coverage were delivered before closing.

A review of the issued title policy is essential because several cases have held that an insured has a duty to confirm that the coverage issued is correct. An insured who fails to do so will be bound by the coverage issued. See *Hallmark Ins. Co. v Superior Court* (1988) 201 CA3d 1014, 1019, 247 CR 638 (reasonable person will read policy to confirm what is covered, ambiguity cannot be claimed later); *Hackethal v National Cas. Co.* (1987) 189 CA3d 1102, 1111, 234 CR 853 (receipt of policy and its acceptance by insured without objection binds both insured and insurer; insured has duty to read policy). See California Liability Insurance Practice: Claims & Litigation §§3.51A-3.61 (Cal CEB 1991) on reconciling these cases with general insurance cases construing ambiguity against insurer.

If the insurer fails to correct a defect in the title policy as requested, the insured may have recourse against the title insurer under a negligence or breach of contract (reformation) theory. On reformation, see §11.44 and Liability Ins Prac §12.43. For discussion of claims against escrow agent, see California Real Property Sales Transactions, chap 15 (4th ed Cal CEB 2007).

PRACTICE TIP: The insured should notify senior management of the title company in writing if the title policy has a defect that is not promptly corrected. The insured may also want to file a complaint with the Department of Insurance. If the defect remains uncorrected and a claim arises, the insured should promptly tender the claim, asserting that the insured received the coverage requested at the closing. The insured may also have a separate cause of action against the escrow company for breach of contract if the escrow instructions precisely described the required policy terms and the escrow agent closed without obtaining the appropriate policy coverage. See §11.47.

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§10.21 2. Advise Client on Adequacy of Policy Over Time

Ordinarily, owners' title insurance policies are issued in a face amount corresponding to the purchase price of the property, while a lender's policy is usually issued in the amount of the loan. Over time, the value of the policy may become inadequate. For example, an owner's policy may not cover the full value of the property, because of inflationary market increases. See §7.103. Under a lender's policy, the loan amount may increase because (a) the borrower defaults in making payments, (b) the lender makes additional advances to the borrower and adds the amount of the advance to the principal balance of the loan, or (c) negative amortization increases the loan amount. Accordingly, counsel should advise clients of the availability of inflation and other appropriate endorsements available from the title company to increase coverage. See §§8.87-8.88.

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11

Theories and Defenses in Title Company Actions

Theodore R. Forrest, Jr.
Timothy R. Sullivan

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I. TITLE INSURER LIABILITY: INTRODUCTION

§11.1 A. Scope of Chapter

Title insurance is a contract in which the insurer agrees to indemnify the insured against losses specified in the policy, such as title defects, liens, encumbrances, or other claims that are adverse to the insured's title and exist at the time the policy is issued. See Ins C §§104, 12340.1; *Vournas v Fidelity Nat'l Title Ins. Co.* (1999) 73 CA4th 668, 86 CR2d 490; *Rosen v Nations Title Ins. Co.* (1997) 56 CA4th 1489, 1499, 66 CR2d 714; *Lawrence v Chicago Title Ins. Co.* (1987) 192 CA3d 70, 74, 237 CR 264. See also §§6.1-6.2, 6.18-6.21. Claims and actions arising from insured interests may be initiated by a first party (the insured owner or lender, see §§11.4-11.37) or by a third party, whose interest such as a lien, an easement, or other encumbrance is insured against (see §§11.51-11.58). Claims procedures are discussed in chap 12, which includes a comprehensive discussion of an insurer's duties to investigate all claims and to defend third party claims that are covered.

This chapter presents the most commonly used theories of liability in legal actions involving title companies. Most of the chapter discusses the remedies available to resolve unsettled title insurance claims. In addition to policy-related claims and defenses, such as coverage and bad faith issues, and torts arising from handling or presenting claims, this chapter addresses liabilities and defenses arising from a title company's performance of related functions, such as escrow agent or, in rare situations, abstractor of title. Litigation strategies are also discussed in chap 13.

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B. Understanding the Basics

§11.2 1. Compare Client Policy With Cases

Before deciding that there is a basis for an insured claim, counsel must bear in mind that coverage depends on the kind of title policy and endorsements involved. Chapters 6-8 comprehensively discuss the risks insured by the policy forms and special endorsements used in California transactions. Title insurance companies periodically revise these forms, and claims may be brought many years after a title policy was issued. See §11.91. Therefore, counsel should be aware that the usefulness of the authorities cited in this chapter will be maximized by carefully comparing the language in the policy at issue with the policy language in the cited cases.

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§11.3 2. Distinguish First Party and Third Party Claims

The Fair Claims Settlement Practices Regulations (regulations) (10 Cal Code Regs §§2695.1-2695.14) apply to title insurers (10 Cal Code Regs §2695.1(b)) and were promulgated under Ins C §790.03(h) to establish minimum standards for investigation and settlement of insurance claims. The regulations define a "first party claimant" as anyone who asserts rights "under an insurance policy as a named insured, other insured, or beneficiary under the terms of that insurance policy." 10 Cal Code Regs §2695.2(f). In other words, a first party claimant may be a policyholder, an additional insured, or a coinsured. See also *Montrose Chem. Corp. v Admiral Ins. Co.* (1995) 10 C4th 645, 663, 42 CR2d 324 (under first party coverage, insurer pays insured "upon the happening of an event, the risk of which has been insured against"). In the domain of title insurance, typical first party (insured) claimants are either owners (see §§11.5-11.9) or lenders (see §§11.10-11.14).

A "third party claimant" is "any person asserting a claim against any person or the interests insured under an insurance policy." 10 Cal Code Regs §2695.2(x). See also *Montrose Chem. Corp. v Admiral Ins. Co., supra* (generally under third party coverage "the carrier assumes a contractual duty to pay judgments the insured becomes legally obligated to pay"). In the title insurance context, typical third party claimants are lienholders in real property insured by a title policy. See §§11.51-11.58 for additional examples of third party claimants in title insurance disputes.

The term "claimant" in the regulations includes both first party and third party claimants. 10 Cal Code Regs §2695.2(c). The regulations acknowledge that a claim may be initiated by either a first party claimant or a third party claimant by sending a "notice of claim" to the insurer. 10 Cal Code Regs §2695.2(n). This chapter discusses both first party and third party claims. Although they have some similarities, each must pursue different courses of action in the claims process, primarily because a third party claimant has no contractual privity with the insurer. The particular differences are discussed throughout this chapter and in chaps 12-13. See, *e.g.,* §§13.5-13.10.

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II. BREACH OF TITLE INSURANCE CONTRACT

§11.4 A. Summary of Remedies

When an insurer refuses to indemnify an insured for covered losses, fails to perform obligations set forth in the policy, or improperly declines to accept the insured's tender of defense of a third party action brought against the insured, one available remedy is an action for breach of the insurance contract. See *Cates Constr., Inc. v Talbot Partners* (1999) 21 C4th 28, 86 CR2d 855; *Amato v Mercury Cas. Co.* (1997) 53 CA4th 825, 831, 61 CR2d 909 (*Amato II*): *Stalberg v Western Title Ins. Co.* (1991) 230 CA3d 1223, 1233, 282 CR 43. Only an insured (or its assignee) may sue for breach of contract against an insurer. As a rule, absent an assignment of rights or a final judgment, a third party claimant may not bring a direct action against an insurance company on the contract, because the insurer's duties flow to the insured. *J. C. Penney Cas. Ins. Co. v M. K.* (1991) 52 C3d 1009, 1018, 278 CR 64; *Clemmer v Hartford Ins. Co.* (1978) 22 C3d 865, 889, 151 CR 285; *Murphy v Allstate Ins. Co.* (1976) 17 C3d 937, 943, 132 CR 424; *Gulf Ins. Co. v TIG Ins. Co.* (2001) 86 CA4th 422, 430, 103 CR2d 305.

However, a claimant may sue the insurer as a third party beneficiary using traditional contract principles. *Harper v Wausau Ins. Corp.* (1997) 56 CA4th 1079, 1086, 66 CR2d 64. Under California law, third party beneficiaries of contracts have the right to enforce the terms of a contract under CC §1559, which provides: "A contract, made expressly for the benefit of a third person, may be enforced by him at any time before the parties thereto rescind it." Traditional third party beneficiary principles do not require that the person to be benefited be named in the contract. *Harper v Wausau Ins. Corp., supra*. For a general discussion of actions for breach of an insurance contract and sample pleadings, see California Liability Insurance Practice: Claims & Litigation, chaps 24-26 (Cal CEB 1991).

An improper denial of coverage or refusal to defend or settle relieves the insured of its contractual obligations to the extent that the insured is no longer required to cooperate with the insurer under certain terms of the policy. *Samson v Transamerica Ins. Co.* (1981) 30 C3d 220, 238, 178 CR 343. The insured is also relieved of the obligation to let the insurer control the defense of a third party action. *Stalberg v Western Title Ins. Co.* (1991) 230 CA3d 1223, 1233, 282 CR 43. The insured may then reasonably settle directly with (and assign its rights against the insurer to) the third party. *Samson v Transamerica Ins. Co.* (1981) 30 C3d 220, 240, 178 CR 343. Such a settlement with an assignment of rights may include a stipulated judgment and a covenant not to execute. *Pruyn v Agricultural Ins. Co.* (1995) 36 CA4th 500, 512, 42 CR2d 295; *Xebec Dev. Partners, Ltd. v National Union Fire Ins. Co.* (1993) 12 CA4th 501, 526, 15 CR2d 726, disapproved on other grounds in *Essex Ins. Co. v Five Star Dye House, Inc.* (2006) 38 C4th 1252, 1265 n4, 45 CR3d 362.

The degree to which such terms make the stipulated judgment binding on the insurer in a third party action against the insurer on the assigned claims is the subject of conflicting appellate decisions. Compare *Pruyn v Agricultural Ins. Co.* (1995) 36 CA4th 500, 42 CR2d 295, and *McLaughlin v National Union Fire Ins. Co.* (1994) 23 CA4th 1132, 29 CR2d 559, with *Smith v State Farm Mut. Auto. Ins. Co.* (1992) 5 CA4th 1104, 7 CR2d 131. A stipulated judgment resulting from fraud or collusion between an insured and a third party is unenforceable against the insurer in any event. See *Andrade v Jennings* (1997) 54 CA4th 307, 62 CR2d 787.

For a general discussion of an insurer's duty to investigate and duty to defend, see §§12.24-12.26, 12.27-12.34, respectively. For further discussion of assignment of claims by an insured to a third party claimant, see Liability Ins Prac §§11.38-11.40, 15.2-15.9A.

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§11.5 B. Liability Under Owner's Policy

Condition 7 of the 1990 CLTA standard coverage policy (CLTA policy, see App H) states that the policy is a contract of indemnity against actual monetary loss or damage sustained or incurred by the insured "by reason of matters insured against by this policy and only to the extent herein described." Condition 7(c) further provides that the insurer's liability under the policy to an insured owner shall not exceed the lesser 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.

Condition 7(a) of the 1992 ALTA owner's policy (see App K) and Condition 8 of the 2006 ALTA owner's policy (see App L) contain similar language. Condition 6 of the CLTA/ALTA homeowner's policies (see App O) contains somewhat different language and states that, after subtracting the deductible amount, the insurer will pay no more than the least of:

> (1) Your actual loss;
>
> (2) Our Maximum Dollar Limit of Liability then in force for the particular Covered Risk, for claims covered only under [certain enumerated] Covered Risk[s] …; or
>
> (3) the Policy Amount then in force….

The authors are not aware of any reported cases interpreting this language from the CLTA/ALTA homeowner's policies.

Condition 7(c) of the 1990 CLTA standard coverage policy, Condition 7(a) of the 1992 ALTA owner's policy, Condition 8 of the 2006 ALTA owner's policy, and Condition 6 of the CLTA/ALTA homeowner's policies all emphasize the requirement that an insured claimant suffer actual monetary loss or damage before the insured may recover under the policy. These conditions mirror the exclusions in all four policies that preclude coverage when the insured claimant suffers no loss. See Exclusion 3(c) in the 1990 CLTA standard coverage policy and the 1992 ALTA owner's policy, "resulting in no loss or damage to the insured claimant," Exclusion 3(c) in the 2006 ALTA owner's policy, "resulting in no loss or damage to the Insured Claimant," and Exclusion 4(c) of the CLTA/ALTA homeowner's policies, "that result in no loss to You."

Although these conditions refer to only one method (other than the policy limits) of calculating damages under an owner's policy, in fact two methods may be used: (1) calculating the cost of removing the defect or lien (see §11.6) or (2) the diminution in value caused by the defect or lien (see §11.7). *Lawrence v Chicago Title Ins. Co.* (1987) 192 CA3d 70, 75, 237 CR 264. In limited circumstances, the insured may also be able to recover consequential damages. See §11.8.

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Source: Real Property/California Title Insurance Practice/11 Theories and Defenses in Title Company Actions/§11.6 1. Cost of Removing Defect or Lien

§11.6 1. Cost of Removing Defect or Lien

Condition 4(b) of the CLTA standard coverage policy authorizes the insurer to prosecute any action or do any other act "necessary or desirable to establish the title to the estate or interest… or to prevent or reduce loss or damage to an insured." Condition 4(b) of the 1992 ALTA owner's policy and Condition 5(b) of the 2006 ALTA owner's policy contain substantially similar language. The CLTA/ALTA homeowner's policies are less specific, but Condition 4(a)(8) gives the insurer the "choice" of taking "other appropriate action," and Condition 5(e) states that, whether or not the insurer agrees there is coverage under the policy, the insurer may "take other appropriate action under this Policy." Although the authors are aware of no reported decisions on point, this language presumably authorizes the insurer to prosecute an action to clear title. Under Condition 8(a) of the CLTA policy, Condition 9(a) of the 1992 and 2006 ALTA owner's policies, and Condition 6 of the CLTA/ALTA homeowner's policies, if the insurer removes the defect or lien with reasonable diligence, the insurer's liability under the policy is terminated and the insurer is not liable for any loss or damage caused by the defect or lien. See §12.52. Older versions of the standard coverage policies require an insurer to take affirmative action to eliminate a title defect. See cases discussed in §§11.28, 12.52-12.53.

If the insurer breaches the insurance contract by failing to take action to remove the defect or lien (as some older policies require), or by exercising its option to do so but failing to act with reasonable diligence (as more recently issued policies require), the insured may then take reasonable steps to remove the defect or lien. In this event, the insured's recovery for the breach should be the reasonable attorney fees, costs, and expenses that the insured incurred to remove the defect or lien.

If the insurer has an obligation to take action to remove the defect or lien but refuses, the insured may do so without much cause for concern. However, an insured should be cautious before taking action to remove the defect or lien if the insurer is also taking action, even if the insured believes that the insurer is not acting in a reasonably diligent manner. If the insurer believes that the insured's actions are interfering with the insurer's attempts to remove the defect or lien, or if the insurer believes that the insured's actions are not reasonable or necessary, the insurer may assert that the insured's actions are a breach of the insured's duty of cooperation under Condition 4(d). See discussion in §§12.40-12.46.

Further, the insurer may assert that the insured's actions breach Condition 8(c) of the CLTA policy or Condition 9(c) of the 1992 and 2006 ALTA owner's policies, which prohibit the insured from voluntarily assuming any liability in settling a claim or suit without the insurer's prior written consent. The insurer may also assert that the insured's actions violate Condition 8(b) of the CLTA policy, which states:

> 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, or, if applicable, to the lien of the insured mortgage, as insured.

Condition 9(b) of the 1992 and 2006 ALTA owner's policies contains similar language. Condition 5 of the CLTA/ALTA homeowner's policies also provides that the insurer is required to pay "only those settlement costs, attorneys' fees and expenses that We approve in advance," and also requires the insured to cooperate with the insurer in handling any claim or legal action.

PRACTICE TIP: In light of the obvious potential for conflict between the insurer's right to a reasonable time in which to eliminate the defect or lien and the insured's desire to have the title cleared as soon as possible, counsel for the insurer should:

- Keep the insured fully informed of all steps the insurer is taking to eliminate the defect or lien. The more the insured knows about the insurer's actions, or at least the insurer's attempts on the insured's behalf, the less likely it is that the insured will blame the insurer for unavoidable delays;
- Inform the insured immediately of any delay and the reason for it;
- Inform the third party claiming the defect or lien that continuances or extensions of time are granted only in

emergencies; and

- Ascertain as soon as possible after deciding to eliminate the defect or lien whether the insured will incur consequential damages while the defect or lien is being eliminated, and consider either reimbursing the insured for its costs and expenses or taking action to mitigate them.

Counsel for the insured should take the following steps:

- Monitor all steps the insurer is taking to eliminate the defect or lien;
- Ask the insurer for a timetable or an estimate of how long each step will take;
- Ask the insurer to explain any delays or deviations from the timetable;
- Inform the insurer as soon as possible if any consequential damages are expected or incurred;
- Before taking any action to eliminate the defect or lien, ask for the insurer's written permission; and
- If the insurer refuses to grant permission for the insured to take action, ask for a written explanation, including why the insurer itself has not already taken the action or why the insurer believes the action to be unnecessary.

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§11.7 2. Diminution in Value

If the defect or lien cannot be removed, the normal measure of damages under the owner's policy is the difference between the value of the insured land or interest without the defect or lien versus its value with the defect or lien. *Native Sun Inv. Group v Ticor Title Ins. Co.* (1987) 189 CA3d 1265, 1274, 235 CR 34. This method of calculating damages should be familiar to attorneys because of its similarity to the "benefit of the bargain" method of calculating damages for breach of a real estate purchase contract (see CC §3306) or fraud (see *Stout v Turney* (1978) 22 C3d 718, 725, 150 CR 637). Under Condition 7 of the CLTA policy and the 1992 ALTA owner's policy and Condition 8(a) of the 2006 ALTA owner's policy, however, the measure of damages calculated under this formula is limited by the face amount set forth in Schedule A of the policy. See also §§6.49, 6.77, 6.84.

The key question in using this method of calculating the damages under an owner's policy is the date on which to value the insured land or interest. Because a title policy insures as of a date certain rather than for a specific period of time, it may be several years between the time the policy is issued and the time a defect or lien is discovered. Loss or damage is calculated as of the date the defect or lien is discovered (measured by the use to which the property is then being devoted), not the purchase date. *Overholtzer v Northern Counties Title Ins. Co.* (1953) 116 CA2d 113, 130, 253 P2d 116. This approach protects the insured against loss resulting from improving the property in reliance on clear title as insured by the policy. As the *Overholtzer* court explained (116 CA2d at 130):

> The insured, when he purchases the policy, does not then know that the title is defective. But later, after he has improved the property, he discovers the defect. Obviously, up to the face amount of the policy, he should be reimbursed for the loss he suffered in reliance on the policy, and that includes the diminution in value of the property as it then exists, in this case with improvements. Any other rule would not give the insured the protection for which he bargained and for which he paid.

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§11.8 3. Consequential Damages

In addition to the cost of removing the defect or lien (or if doing so is not possible, the diminution in value of the land or interest because of the defect or lien), the insured may, in an appropriate case, recover consequential damages. *Native Sun Inv. Group v Ticor Title Ins. Co.* (1987) 189 CA3d 1265, 1274, 235 CR 34. For example, in *Nebo, Inc. v Transamerica Title Ins. Co.* (1971) 21 CA3d 222, 227, 98 CR 237, the appellate court affirmed an award to the insured based on a finding that, although the insurer filed suit to clear title, it had failed to clear title within a reasonable time. The *Nebo* court affirmed an award that included the rent the insured could not collect because of the title defect during the pendency of the quiet title action, and concluded that the insured's inability to collect rents was caused by the defect. *Nebo* is discussed further in §§11.81, 12.52.

The insured must prove that the defect or lien caused the damages. For example, in *Native Sun Inv. Group v Ticor Title Ins. Co., supra*, the court affirmed a ruling denying the insured recovery of "carrying costs," *i.e.*, interest, taxes, and other costs associated with owning the property and carrying a mortgage. The court reasoned that, because the insured would incur such costs even if there were no title defect, the carrying costs were not caused by the defect and thus were not recoverable.

Other types of consequential damages may be available, depending on the application of CC §3300. See *California Shoppers, Inc. v Royal Globe Ins. Co.* (1985) 175 CA3d 1, 59, 221 CR 171 (insured could recover only damages within parties' reasonable contemplation when policy was acquired). For further discussion of other consequential damages and prejudgment interest that may be available for breach of liability insurance contracts, see California Liability Insurance Practice: Claims & Litigation §§24.60-24.66 (Cal CEB 1991).

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§11.9 4. Damages for Failure to Defend

If the insurer fails to defend a claim that is potentially covered by the policy, even if in "good faith" (*i.e.,* with reasonable justification), the failure to defend is a breach of the insurance contract. *Campbell v Superior Court* (1996) 44 CA4th 1308, 1321, 52 CR2d 385. The insured is then entitled to conduct its own defense and recover, at a minimum, all reasonable attorney fees, expenses, and costs of defending the underlying action from the insurer. *Comunale v Traders & Gen. Ins. Co.* (1958) 50 C2d 654, 328 P2d 198; *Ringler Assocs. v Maryland Cas. Co.* (2000) 80 CA4th 1165, 1187, 96 CR2d 136; *Amato v Mercury Cas. Co.* (1993) 18 CA4th 1784, 1793, 23 CR2d 73 (*Amato I*); *Stalberg v Western Title Ins. Co.* (1991) 230 CA3d 1223, 1233, 282 CR 43; *California Shoppers, Inc. v Royal Globe Ins. Co.* (1985) 175 CA3d 1, 15, 221 CR 171. Under the language of the form policies, defense costs do not reduce the amount of insurance set forth in Schedule A of the policy. It is possible, therefore, that the damages recoverable by an insured for the failure to defend may exceed the policy limits.

An insurer's wrongful refusal to defend may subject the insurer to liability for all or part of an adverse judgment against the insured, if the insured demonstrates that the judgment falls within the scope of the insurer's indemnity obligation under the policy. Compare, *e.g., Hogan v Midland Nat'l Ins. Co.* (1970) 3 C3d 553, 91 CR 153, disapproved on other grounds in 16 C4th at 56, and *Geddes & Smith, Inc. v St. Paul Mercury Indem. Co.* (1965) 63 C2d 602, 609, 47 CR 564, with *Kapelus v United Title Guar. Co.* (1971) 15 CA3d 648, 653, 93 CR 278 (title insurer found liable for amount of judgment *automatically* even though judgment based on theory *outside policy coverage*).

Moreover, if the insurer's wrongful refusal to defend renders the insured financially unable to mount a defense to the underlying action and the insured suffers a default judgment, the insurer is liable for that judgment. *Amato v Mercury Cas. Co.* (1997) 53 CA4th 825, 831, 61 CR2d 909 (*Amato II*). Even if a subsequent action on the default judgment establishes it would not have been covered, the insurer is still liable for the entire amount of the default judgment. 53 CA4th at 833. The insured is not required to conduct a "trial within a trial" to prove that if the insurer had defended him or her, the amount of the default judgment would have been smaller. 53 CA4th at 835. See California Liability Insurance Practice: Claims & Litigation §§25.29-25.39 (Cal CEB 1991) for further discussion of damages generally available to an insured for the insurer's failure to defend.

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§11.10 C. Liability Under Lender's Policy

The nature of a lender's interest, which is only a security interest in the property, differs from that of the owner, who has title to the property. Consequently, the method of calculating the lender's loss or damage from a title defect also differs. Because the lender's interest is not immediately diminished by the presence of a lien, the loss cannot be measured unless a default occurs on the underlying debt and the security for the insured loan proves to be inadequate. *Karl v Commonwealth Land Title Ins. Co.* (1993) 20 CA4th 972, 982, 24 CR2d 912 (*Karl I*).

As the court noted in *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 427, 275 CR 107, title insurance indemnifies a lender "only against loss with respect to the secured indebtedness, not a diminution of profits potentially obtainable from resale of the property."

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§11.11 1. General Measure of Damage or Loss

Generally, the insured lender's loss or damage from a title defect is the lesser of (a) the face amount of the policy set forth in Schedule A, (b) the remaining balance of principal, interest, and associated expenses (foreclosure expenses) calculated at the time the loss occurs, or (c) the difference between the value of the lender's interest as insured and the value of such interest subject to the defect insured against. Condition 8(a) 2006 ALTA lender's policy (see App L), Condition 7(a) 1992 ALTA lender's policy (see App K), and CLTA policy (see App H).

This measure may be characterized for practical purposes as the amount of money required to remove the prior lien. See *Lawrence v Chicago Title Ins. Co.* (1987) 192 CA3d 70, 75, 237 CR 264. The *Lawrence* court stated: "Although we cannot say that such measure of indemnification would be appropriate in all cases under all policies, such measure would be appropriate in most cases." 192 CA3d at 75. Further, if the deed of trust authorizes the lender to recover the value of time and money spent to repair or maintain the property in order to protect the lender's lien, such amounts may be included in the measure of the lender's damages. *Karl v Commonwealth Land Title Ins. Co.* (1993) 20 CA4th 972, 977, 24 CR2d 912 (*Karl I*).

There is a split of authority on the date for establishing loss. See §§11.12-11.14. It is the fair market value of the property, however, and not the amount of the credit bid that establishes the size of the loss. That value may not be discounted by the acquiring lender to take liquidation costs into account. *Karl v Commonwealth Land Title Ins. Co.* (1997) 60 CA4th 858, 871, 70 CR2d 374 (*Karl II*). If the fair market value of the property is sufficient to cover the balance of the insured loan and senior interests insured against, the lender does not suffer a loss for title insurance purposes.

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§11.12 2. Split of Authority on Date for Establishing Loss

Currently, there is a split at the appellate court level with respect to the date on which the insured lender's damage or loss is to be measured. One view is that the damage cannot be assessed until after a resale of the property following foreclosure by the insured lender. See §11.13. The second view allows damage to the lender to be established as early as the date of foreclosure. See §11.14.

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§11.13 a. On Resale After Foreclosure

In *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 427, 275 CR 107, the insured lender held what it believed to be a second deed of trust and, after the owner defaulted, discovered three liens that were senior to its deed of trust. The lender filed a claim for the amount needed to remove the three prior liens. The insurer rejected the claim as premature in that the lender had not yet suffered a loss. The lender ultimately foreclosed and bought the property at the foreclosure sale for a credit bid of $1, subject to the senior liens. The lender again made a claim under the policy, and again it was denied.

The appellate court in *Cale* affirmed summary judgment in the insurer's favor, finding that the lender failed to prove that he had been damaged by the existence of the senior liens. The court observed that, when a lender buys the property at the foreclosure sale, the sales price does not establish the fair market value, and, in any event, the indemnifiable loss to the lender is measured by the extent to which the debt is uncollected, not by the extent to which the value of the security is reduced by the senior liens. The court further noted that the policy continued to insure the deed of trust and that no showing was made that the property's value was insufficient to secure the amount of the underlying loan. Finally, the court stated that a covered loss may occur in the future, if one of the senior lienors foreclosed or if the lender sold the property on the open market, but only to the extent that the proceeds were insufficient to pay off the insured's loan. 225 CA3d at 428. See §§11.73, 11.96. See §11.14 for a contrary opinion.

NOTE: The *Cale* decision appears to have been driven by the insured lender's position that its $1 credit bid established the property's value and that the lender therefore suffered a loss. The underlying rationale of this decision is that title insurance does not indemnify a lender for lost profits. See §11.10.

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§11.14 b. On Foreclosure Date

In *Karl v Commonwealth Land Title Ins. Co.* (1993) 20 CA4th 972, 985, 24 CR2d 912 (*Karl I*), the fourth appellate district rejected the third district's holding in *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 427, 275 CR 107, on the issue of when an insurable loss occurred. The *Karl I* court ruled that, when an insured lender can show that it was damaged on foreclosure, the title insurer cannot avoid its policy obligations by merely offering to continue to insure the lender. The *Karl I* court held that the *earliest* date an insured lender's damage may be ascertained is the date of foreclosure, but that the credit bid does not reflect the fair market value of the property. However, the lender must prove both of the following:

- That the value of the subject property is less than the total of the lender's lien plus all prior liens. This proof is required because, if the value of the property obtained at foreclosure were sufficient to satisfy all liens, including the insured lender's, the insured would suffer no damage.
- That the value of the subject property (exclusive of all liens) is greater than the total amount of the disclosed senior liens. This proof is required because, if the value (exclusive of all liens) does not exceed the amount of the senior liens, the insured would not have recovered on his lien even if the undisclosed liens had not existed. An insured lender cannot make an insurer indemnify the lender's bad judgment in securing a loan for property whose value would not even secure the first lien.

The *Karl I* court reasoned (20 CA4th at 985):

> The "fair market value as of foreclosure" approach also eliminates other concerns raised by the plaintiffs which otherwise are inherent in a delayed determination of loss. For example, following foreclosure lenders may invest cash or their own time and effort in renovation of the property. An increase in market value as a result of such contribution should not redound to the benefit of the insurer. Similarly, a lender's expertise in marketing which results in a sale at a higher than market value should not profit the insurer [citation omitted]. Finally, it seems unfair to measure damage by a market sale which may occur at a time distant from the date of foreclosure, during which period inflation or deflation may have altered the value of the property. A rule requiring measurement of loss as of the date of foreclosure eliminates these troublesome issues. It also permits maturation of the claim against the title insurer.

In a second appeal after remand, the fourth appellate district repeated its holding that it is the fair market value of the property on the foreclosure date that fixes the size of the loss. *Karl v Commonwealth Land Title Ins. Co.* (1997) 60 CA4th 858, 70 CR2d 374 (*Karl II*).

NOTE: The decisions in *Cale, Karl I,* and *Karl II* agree that the sales price of property purchased by a credit bid at a trustee's sale does not reflect the property's fair market value. Moreover, all three cases essentially stand for the proposition that an insured lender is entitled to indemnification only for the unpaid balance of the secured debt, not for lost profits resulting from diminution in value of the security caused by senior liens or a title defect. See also §11.96.

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§11.15 D. Actions for Declaratory Relief

A declaratory relief action may be filed by any party with an interest in a contract to determine, among other things, the respective rights and duties of the parties to the contract. Declaratory relief actions are often used to resolve liability insurance coverage disputes. See, *e.g., Montrose Chem. Corp. v Superior Court* (1993) 6 C4th 287, 301, 24 CR2d 467; *Safeco Title Ins. Co. v Moskopoulos* (1981) 116 CA3d 658, 663, 172 CR 248. These actions are generally governed by CCP §§1060-1062.5. The plaintiff commences the action, and the defendant responds by answering and may also file a cross-complaint if the defendant wishes to frame the issues differently from the complaint. *Buss v Superior Court* (1997) 16 C4th 35, 42, 65 CR2d 366.

Although used most often by insurers, declaratory relief actions are sometimes filed by insureds. *Buss v Superior Court, supra*. These actions may be combined in a lawsuit filed by the insured with other remedies such as damages for breach of the title insurance contract or bad faith (breach of the covenant of good faith and fair dealing). Declaratory relief may also be sought by third party claimants but only as a cross-complaint if the third party claimant is a defendant in a declaratory relief action filed by the insurer. See *Canadian Ins. v Rusty's Island* (1995) 36 CA4th 491, 495, 42 CR2d 505.

PRACTICE TIP: *Trial Preference:* One possible advantage to bringing a declaratory relief action independently of other actions on policy coverage issues is that declaratory relief actions, when filed separately from other causes of action, have preference in trial setting over all other civil actions. CCP §1062.3. However, if the coverage question turns on facts to be litigated in the underlying action, the insured may obtain a stay of the declaratory relief action in order to eliminate the risk of inconsistent factual determinations, which could prejudice the insured. *Montrose Chem. Corp. v Superior Court, supra*; *Kleis v Superior Court* (1995) 37 CA4th 1035, 1051, 44 CR2d 181. See §12.59.

In addition to resolving defense or liability coverage issues, an action for declaratory relief may be used to ascertain whether an insurer must provide the insured with independent counsel in a third party lawsuit. *United States Fid. & Guar. Co. v Superior Court* (1988) 204 CA3d 1513, 1526, 252 CR 320. The use of a declaratory relief action to resolve issues under a title insurance policy may be complicated by the pendency of an underlying third party action. See discussion in §12.59, 13.9.

PRACTICE TIP: *When to File:* Whether the insured should file a declaratory relief action during the pendency of a third party lawsuit is chiefly a question of strategy. For example, if the underlying suit is anticipated to be lengthy or complex and thus expensive to defend, or if third party damages are high, then early resolution of the coverage issues would assist the insured in knowing whether it will have the ultimate responsibility for the costs of defending the third party claim. Actions for declaratory relief are frequently filed by the insurer early on, essentially for the same reasons. If an insurer were to obtain an early declaratory judgment that it has no duty to defend the underlying action, it may avoid unnecessary defense expenses and the risks of breach of contract and bad faith claims, which might result from an unjustified refusal to indemnify the insured or defend the underlying action.

A summary judgment motion may be advantageous in an action for declaratory relief in which coverage is a question of policy interpretation, *i.e.*, a question of law. See §§13.34, 13.36. For a comprehensive discussion of the uses and limitations of declaratory relief actions in resolving liability insurance coverage issues generally, see California Liability Insurance Practice: Claims & Litigation, chap 20 (Cal CEB 1991).

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III. BREACH OF DUTY OF GOOD FAITH AND FAIR DEALING

§11.16 A. Summary of Theory; Remedies

In addition to the duties imposed on contracting parties by the express terms of their agreement, the law implies in every contract a covenant of good faith and fair dealing. This covenant requires both insurer and insured to refrain from doing anything to impair the other's right to the benefits of the insurance contract. *Waller v Truck Ins. Exch.* (1995) 11 C4th 1, 36, 44 CR2d 370; *Egan v Mutual of Omaha Ins. Co.* (1979) 24 C3d 809, 818, 169 CR 691; *Crisci v Security Ins. Co.* (1967) 66 C2d 425, 429, 58 CR 13; *Comunale v Traders & Gen. Ins. Co.* (1958) 50 C2d 654, 658, 328 P2d 198; *Chateau Chamberay Homeowners Ass'n v Associated Int'l Ins. Co.* (2001) 90 CA4th 335, 108 CR2d 776; *Century Sur. Co. v Polisso* (2006) 139 CA4th 922, 948, 43 CR3d 468.

Without a contractual relationship, the implied covenant of good faith and fair dealing does not exist. *Waller v Truck Ins. Exch., supra*; *Rosen v Nations Title Ins. Co.* (1997) 56 CA4th 1489, 1496, 66 CR2d 714; *Golden Sec. Thrift & Loan Ass'n v First Am. Title Ins. Co.* (1997) 53 CA4th 250, 258, 61 CR2d 442; *Jones v Aetna Cas. & Sur. Co.* (1994) 26 CA4th 1717, 1722, 33 CR2d 291; *Hatchwell v Blue Shield* (1988) 198 CA3d 1027, 1034, 244 CR 249; *Austero v National Cas. Co.* (1976) 62 CA3d 511, 516, 133 CR 107. Bad faith lawsuits by third party claimants are therefore not available as a remedy against insurance companies for mishandling third party claims. *Moradi-Shalal v Fireman's Fund Ins. Cos.* (1988) 46 C3d 287, 250 CR 116; *Murphy v Allstate Ins. Co.* (1976) 17 C3d 937, 944, 132 CR 424. See §11.29. Nor are bad faith suits allowed by the insurer against the insured. *Kransco v American Empire Surplus Lines Ins. Co.* (2000) 23 C4th 390, 406, 97 CR2d 151; *Agricultural Ins. Co. v Superior Court* (1999) 70 CA4th 385, 82 CR2d 594. An insured, however, may assign its rights in a bad faith claim against its insurer to the third party claimant in the same manner as a claim for breach of the insurance contract. See §11.4.

When benefits are due under the policy, a delayed payment based on inadequate or tardy investigation, oppressive conduct by claims adjusters seeking to reduce the amounts legitimately payable, a refusal to defend a third party action against the insured, or numerous other tactics may breach the covenant because they frustrate the insured's right to receive the benefits of the contract in prompt compensation for losses. See, *e.g., Stalberg v Western Title Ins. Co.* (1991) 230 CA3d 1223, 1233, 282 CR 43. See also §§12.19, 12.24-12.26, 12.35-12.38. However, if the policy provides no potential basis for coverage, and no duty to defend or indemnify arises, then a refusal to defend an action or pay a claim does not reach the level of a breach of the covenant. *Waller v Truck Ins. Exch., supra*; *Love v Fire Ins. Exch.* (1990) 221 CA3d 1136, 1153, 271 CR 246. See §§12.27-12.34.

In limited circumstances, an insurer may be liable to its insured for bad faith even if the policy does not cover the disputed claim. *Murray v State Farm Fire & Cas. Co.* (1990) 219 CA3d 58, 66 n5, 268 CR 33 (dicta; when insurer unreasonably delays investigation of claim before denying coverage and delay causes insured consequential damages). *McMillin Scripps N. Partnership v Royal Ins. Co.* (1993) 19 CA4th 1215, 1222, 23 CR2d 243 (dicta; citing with approval out-of-state case: insurer refused to disclose to insured results of investigation, showing that loss was caused by another of insurer's policyholders, who had liability coverage).

Not every insurer mistake is sufficient to support a bad faith claim. Some appellate decisions have held that, to find bad faith, the insurer's denial of benefits or other conduct must be "unreasonable" (*McCoy v Progressive W. Ins. Co.* (2009) 171 CA4th 785, 793, 90 CR3d 74; *Chateau Chamberay Homeowners Ass'n v Associated Int'l Ins. Co.* (2001) 90 CA4th 335, 108 CR2d 776; *Austero v National Cas. Co.* (1978) 84 CA3d 1, 27, 32, 148 CR 653, disapproved on other grounds in *Egan v Mutual of Omaha Ins. Co.* (1979) 24 C3d 809, 824 n7, 157 CR 482) or "without proper cause" (*Century Sur. Co. v Polisso* (2006) 139 CA4th 922, 949, 43 CR3d 468; *California Shoppers, Inc. v Royal Globe Ins. Co.* (1985) 175 CA3d 1, 54, 221 CR 171). See also *Congleton v National Union Fire Ins. Co.* (1987) 189 CA3d 51, 59, 234 CR 218 (reasonable but erroneous interpretation of policy resulting in denial of coverage did not support action for bad faith).

Other appellate decisions have held that, in a legitimate dispute over damages or the interpretation of a policy provision, the insurer's withholding of benefits will not support a bad faith claim. See *Jordan v Allstate Ins. Co.* (2007)

148 CA4th 1062, 1072, 56 CR3d 312 ("Where there is a *genuine issue* as to the insurer's liability under the policy for the claim asserted by the insured, there can be no bad faith liability imposed on the insurer for advancing its side of that dispute."); *McCoy v Progressive W. Ins. Co.* (2009) 171 CA4th 785, 793, 90 CR3d 74; *Walbrook Ins. Co. v Liberty Mut. Ins. Co.* (1992) 5 CA4th 1445, 1459, 7 CR2d 513 (liability for bad faith cannot lie on failure to accept settlement offer based solely on mistake in judgment or failure to correctly predict outcome of lawsuit); *Opsal v United Servs. Auto. Ass'n* (1991) 2 CA4th 1197, 1205, 10 CR2d 352 (existence of genuine coverage issue negated bad faith). See also discussion of genuine dispute doctrine in §11.103A.

There is no set formula or list describing the limits of the insurer's duty of good faith and fair dealing. As the California Supreme Court noted in *Egan v Mutual of Omaha Ins. Co.* (1979) 24 C3d 809, 818, 169 CR 691, "the precise nature and extent of the duty imposed by such an implied promise will depend on the contractual purposes." Thus the scope of the covenant of good faith and fair dealing continues to be a developing area of insurance law. See also *Chateau Chamberay Homeowners Ass'n v Associated Int'l Ins. Co., supra.*

Defenses to bad faith actions are discussed in §§11.103-11.111. For a detailed examination of an insurer's duty of good faith and fair dealing, see California Liability Insurance Practice: Claims & Litigation, chap 24 (Cal CEB 1991). For sample forms of complaints by an insured against an insurance company for breach of contract or breach of the covenant of good faith and fair dealing, see Liability Ins Prac §§25.40, 26.36.

PRACTICE TIP: Litigating coverage claims against an insurance company is seldom easy or inexpensive. Unless the disputed amount is quite large, even if the insured wins, the victory may be so costly that the attorney fees, costs, and expenses nearly equal or even exceed the amount of the verdict. Consequently, counsel for insureds often pursue "bad faith" claims in conjunction with other claims. If, in addition to establishing a duty to defend or indemnify, the insured can prove that the insurer acted in bad faith, the insured may then seek to recover tort damages, including consequential economic damages, emotional distress damages, attorney fees, and costs incurred in proving coverage, and, on proper proof, punitive damages. See §§11.30-11.35G.

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§11.17 B. Applicability to Title Insurers

The implied covenant of good faith and fair dealing applies to title insurance contracts. *White v Western Title Ins. Co.* (1985) 40 C3d 870, 885, 221 CR 509; *Jarchow v Transamerica Title Ins. Co.* (1975) 48 CA3d 917, 940, 122 CR 470, overruled on other grounds in 184 CA3d at 434. See also *Kleveland v Chicago Title Ins. Co.* (2006) 141 CA4th 761, 46 CR3d 314; *Stalberg v Western Title Ins. Co.* (1991) 230 CA3d 1223, 1233, 282 CR 43. In general, however, when no benefits are owed to an insured under the policy, the insurer will not be found to have breached the insurance contract or committed bad faith. *Manneck v Lawyers Title Ins. Corp.* (1994) 28 CA4th 1294, 1303, 33 CR2d 771; *Barczewski v Commonwealth Land Title Ins. Co.* (1989) 210 CA3d 406, 410, 258 CR 386. See also *R&B Auto Center, Inc. v Farmers Group, Inc.* (2006) 140 CA4th 327, 353, 44 CR3d 426; *Benavides v State Farm Gen. Ins. Co.* (2006) 136 CA4th 1241, 1250, 39 CR3d 650; *Waller v Truck Ins. Exch.* (1995) 11 C4th 1, 35, 44 CR2d 370; *McMillin Scripps N. Partnership v Royal Ins. Co.* (1993) 19 CA4th 1215, 1222, 23 CR2d 243; *Murray v State Farm Fire & Cas. Co.* (1990) 219 CA3d 58, 65, 268 CR 33.

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§11.18 C. Examples: Bad Faith Established

The following sections (§§11.19-11.21) contain examples of conduct that was found to violate the implied covenant of good faith and fair dealing. These lists are by no means exhaustive.

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Source: Real Property/California Title Insurance Practice/11 Theories and Defenses in Title Company Actions/§11.19 1. Investigation of Facts or Coverage

§11.19 1. Investigation of Facts or Coverage

- Failing to investigate thoroughly a claim before denying coverage or refusing a defense. *Egan v Mutual of Omaha Ins. Co.* (1979) 24 C3d 809, 817, 169 CR 691; *Baron v Fire Ins. Exch.* (2007) 154 CA4th 1184, 1186, 65 CR3d 502; *Shade Foods, Inc. v Innovative Prods. Sales & Mktg., Inc.* (2000) 78 CA4th 847, 879, 93 CR2d 364; *Stalberg v Western Title Ins. Co.* (1991) 230 CA3d 1223, 1233, 282 CR 43; *Hughes v Blue Cross* (1989) 215 CA3d 832, 846, 263 CR 850. See also *McMillin Scripps N. Partnership v Royal Ins. Co.* (1993) 19 CA4th 1215, 1222, 23 CR2d 243 (dicta approving ruling in out-of-state case; insurer acts in bad faith by refusing to disclose to insured results of investigation proving that loss was caused by another policyholder who had liability coverage). See §§12.24-12.26.
- Failing to investigate diligently a claim and ignoring information supporting a basis for coverage. *Wilson v 21st Century Ins. Co.* (2007) 42 C4th 713, 721, 68 CR3d 746; *Mariscal v Old Republic Life Ins. Co.* (1996) 42 CA4th 1617, 1620, 50 CR2d 224. See §12.25.
- Knowingly using an incorrect standard or an unduly restrictive interpretation of policy terms or conditions. *Tilbury Constructors, Inc. v State Comp. Ins. Fund* (2006) 137 CA4th 466, 475, 40 CR3d 392; *Progressive West Ins. Co. v Superior Court* (2005) 135 CA4th 263, 277, 37 CR3d 434; *Hughes v Blue Cross* (1989) 215 CA3d 832, 847, 263 CR 850; *Delgado v Heritage Life Ins. Co.* (1984) 157 CA3d 262, 278, 203 CR 672; *Moore v American United Life Ins. Co.* (1984) 150 CA3d 610, 638, 197 CR 878. See also §§12.8-12.12.
- Adopting a "pay as a last resort" policy or compelling insureds to arbitrate when coverage is clear. *Richardson v Employers Liab. Assur. Corp.* (1972) 25 CA3d 232, 245, 102 CR 547, overruled on other grounds in *Gruenberg v Aetna Ins. Co.* (1973) 9 C3d 566, 580 n10, 108 CR 480.
- Arbitrary and unreasonable demands for proof of loss. *McCormick v Sentinel Life Ins. Co.* (1984) 153 CA3d 1030, 1046, 200 CR 732. See §§12.16-12.23.
- Unreasonable delays in making a coverage determination or dilatory claims handling. *Hulett v Farmers Ins. Exch.* (1992) 10 CA4th 1051, 1060, 12 CR2d 902; *Fleming v Safeco Ins. Co.* (1984) 160 CA3d 31, 37, 206 CR 313; *McCormick v Sentinel Life Ins. Co.* (1984) 153 CA3d 1030, 1049, 200 CR 732. See §12.36.
- Failing to follow legal advice or advice of knowledgeable claims personnel or other experts. *Tibbs v Great Am. Ins. Co.* (9th Cir 1985) 755 F2d 1370, 1375; *Kinder v Western Pioneer Ins. Co.* (1965) 231 CA2d 894, 901, 42 CR 394.

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Source: Real Property/California Title Insurance Practice/11 Theories and Defenses in Title Company Actions/§11.20 2. Handling of Claims or Defense

§11.20 2. Handling of Claims or Defense

- Deceptive practices to avoid payment or defense of a claim. *Stalberg v Western Title Ins. Co.* (1991) 230 CA3d 1223, 1234, 282 CR 43; *Moore v American United Life Ins. Co.* (1984) 150 CA3d 610, 627, 197 CR 878. See chap 12.
- Breakdown of communications with the insured. *Delgado v Heritage Life Ins. Co.* (1984) 157 CA3d 262, 277, 203 CR 672. See also §§12.39-12.46.
- Failing to advise the insured of the right to arbitration or of other rights under the policy when the insurer has reason to believe that the insured is unaware of those rights. *Sarchett v Blue Shield* (1987) 43 C3d 1, 15, 233 CR 76; *Davis v Blue Cross* (1979) 25 C3d 418, 424, 158 CR 828.
- Unreasonable refusal to defend a third party action against the insured. *Campbell v Superior Court* (1996) 44 CA4th 1308, 1319, 52 CR2d 385. See §§12.17-12.34.
- Mishandling the insured's defense. *Travelers Ins. Co. v Lesher* (1986) 187 CA3d 169, 191, 231 CR 791, disapproved on other grounds in *Buss v Superior Court* (1997) 16 C4th 35, 50 n12, 65 CR2d 366.
- Unreasonable conduct during litigation between insured and insurer. *White v Western Title Ins. Co.* (1985) 40 C3d 870, 885, 221 CR 509.

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§11.21 3. Settlement of Claims

- Settling a third party claim in a manner that injures the insured's rights. *Barney v Aetna Cas. & Sur. Co.* (1986) 185 CA3d 966, 977, 230 CR 215. See §§11.4, 11.16.
- Failure to make an independent evaluation of a settlement demand by a third party or to seek counsel's advice on a settlement demand. *Garner v American Mut. Liab. Ins. Co.* (1973) 31 CA3d 843, 848, 107 CR 604.
- Deliberately delaying settlement of a valid claim for the insurer's own benefit. *Bodenhamer v Superior Court* (1987) 192 CA3d 1472, 1478, 238 CR 177; *Beck v State Farm Mut. Auto. Ins. Co.* (1976) 54 CA3d 347, 354, 126 CR 602.
- Omitting a potential insured from settlement discussions. *Rankin v Curtis* (1986) 183 CA3d 939, 945, 228 CR 753; *Anguiano v Allstate Ins. Co.* (9th Cir 2000) 209 F3d 1167, 1169.
- Settling claims against the insured in a way that leaves the insured exposed to additional damages. *Palmer v Financial Indem. Co.* (1963) 215 CA2d 419, 431, 30 CR 204.
- Settling the claim for an amount above the policy limits without the insured's consent. *Ivy v Pacific Auto. Ins. Co.* (1958) 156 CA2d 652, 661, 663, 320 P2d 140.
- Abusive or coercive practices to compel compromise of a claim. *Egan v Mutual of Omaha Ins. Co.* (1979) 24 C3d 809, 821, 169 CR 691.
- Failure to advise insured about settlement negotiations when there is a risk of an excess or uncovered judgment. *Betts v Allstate Ins. Co.* (1984) 154 CA3d 688, 703, 201 CR 528; *Cain v State Farm Mut. Auto. Ins. Co.* (1975) 47 CA3d 783, 791, 121 CR 200; *Merritt v Reserve Ins. Co.* (1973) 34 CA3d 858, 875, 110 CR 511.
- Failure to settle until eve of arbitration when damages exceeded policy limit and liability was clear. *Singer v State Farm Mut. Auto. Ins. Co.* (9th Cir 1997) 116 F3d 373, 378.
- Adopting a blanket rule against contacting the insured to ask whether the insured would consent to disclosing policy limits to claimants, resulting in the loss of settlement opportunities. *Boicourt v Amex Assur. Co.* (2000) 78 CA4th 1390, 1400, 93 CR2d 763.
- Payment of full benefits to one insured, with knowledge of the other insured's competing claim to the same limited pool of insurance funds, even though the second claim had not yet matured to the point of requiring immediate payment. *Schwartz v State Farm Fire & Cas. Co.* (2001) 88 CA4th 1329, 1339, 106 CR2d 523.
- Payment of liability policy limits on behalf of one insured, without obtaining a release in favor of a second insured. *Shell Oil Co. v National Union Fire Ins. Co.* (1996) 44 CA4th 1633, 1647, 52 CR2d 580.
- Settling a case without paying a known lien on the judgment. *Levin v Gulf Ins. Group* (1999) 69 CA4th 1282, 1285, 82 CR2d 228.

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§11.22 D. Examples: Bad Faith Not Found

Sections 11.23-11.26 provide examples of conduct that courts have held did not rise to the level of bad faith. Again, counsel should keep in mind that these lists are by no means exhaustive.

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§11.23 1. Investigation of Facts or Coverage

- Refusal to prosecute a quiet title action because "forced removal" coverage did not require the insurer to take affirmative action. *Manneck v Lawyers Title Ins. Corp.* (1994) 28 CA4th 1294, 1303, 33 CR2d 771. See §11.86.
- Refusal to defend claim proper when no potential for coverage existed, because claim based on tortious conduct of insured. *Barczewski v Commonwealth Land Title Ins. Co.* (1989) 210 CA3d 406, 413, 258 CR 386. See §12.32.
- Refusal to provide benefits when the insurer interpreted an ambiguous policy provision to exclude coverage, as long as the insurer's interpretation is not inherently unreasonable. *Congleton v National Union Fire Ins. Co.* (1987) 189 CA3d 51, 58, 234 CR 218; *Hanson v Prudential Ins. Co.* (9th Cir 1985) 783 F2d 762, 766.
- Refusal to defend based on a reasonable but mistaken belief that there is no coverage. *California Shoppers, Inc. v Royal Globe Ins. Co.* (1985) 175 CA3d 1, 15, 221 CR 171 (although court held that this constituted breach of contract). See §§12.13, 12.36.
- Failure to exhaust every conceivable avenue in investigating the claim. *California Shoppers, Inc. v Royal Globe Ins. Co.* (1985) 175 CA3d 1, 54, 221 CR 171; *Blake v Aetna Life Ins. Co.* (1979) 99 CA3d 901, 921, 160 CR 528; *Davy v Public Nat'l Ins. Co.* (1960) 181 CA2d 387, 397, 5 CR 488; *Othman v Globe Indem. Co.* (9th Cir 1985) 759 F2d 1458, 1464. See §§12.24-12.26.

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§11.24 2. Handling of Claims or Defense

- Refusal to pay policy limits coupled with continuing to defend the insured at trial so that the plaintiff could avoid an "empty chair" argument. *Heredia v Farmers Ins. Exch.* (1991) 228 CA3d 1345, 1357, 279 CR 511. See §§12.54-12.55.
- Failure to provide coverage information or additional benefits beyond those in the policy. *Shultz Steel Co. v Hartford Acc. & Indem. Co.* (1986) 187 CA3d 513, 524, 231 CR 715; *Gibson v Government Employees Ins. Co.* (1984) 162 CA3d 441, 450, 208 CR 511. See generally §§12.35-12.38.

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§11.25 3. Settlement of Claims

- Refusal to accept a settlement demand within policy limits, which would not result in a full release of all claims against all insureds. *Strauss v Farmers Ins. Exch.* (1994) 26 CA4th 1017, 31 CR2d 811; *Coe v State Farm Mut. Auto. Ins. Co.* (1977) 66 CA3d 981, 993, 136 CR 331. Refusal to settle a disputed claim when the insured was deceased and the insured's estate had no assets at risk. *Shapero v Allstate Ins. Co.* (1971) 14 CA3d 433, 92 CR 244.
- Failure to initiate settlement negotiations. Compare *Merritt v Reserve Ins. Co.* (1973) 34 CA3d 858, 877, 110 CR 511, with *Garner v American Mut. Liab. Ins. Co.* (1973) 31 CA3d 843, 848, 107 CR 604 (dicta); *Brown v Guaranty Ins. Co.* (1957) 155 CA2d 679, 689, 319 P2d 69 (dicta); and *Pray v Foremost Ins. Co.* (9th Cir 1985) 767 F2d 1329, 1330 (dicta; involved Ins C §790.03 claim).
- Refusal to settle when there is no potential for an excess judgment. Compare *Finkelstein v 20th Century Ins. Co.* (1992) 11 CA4th 926, 929, 14 CR2d 305, and *Doser v Middlesex Mut. Ins. Co.* (1980) 101 CA3d 883, 891, 162 CR 115, with *Camelot by the Bay Condominium Owners' Ass'n v Scottsdale Ins. Co.* (1994) 27 CA4th 33, 48, 32 CR2d 354 (dicta).
- Refusal to settle when there is a bona fide dispute over coverage or the amount of the loss. *Austero v National Cas. Co.* (1978) 84 CA3d 1, 22, 148 CR 653, disapproved on other grounds in *Egan v Mutual of Omaha Ins. Co.* (1979) 24 C3d 809, 824 n7, 157 CR 482; *Safeco Ins. Co. v Guyton* (9th Cir 1982) 692 F2d 551, 556.
- Negotiating a settlement obligating the insurer to pay some or all of the settlement under a deductible or self-insured retention. *New Hampshire Ins. Co. v Ridout Roofing Co.* (1998) 68 CA4th 495, 505, 80 CR2d 286.

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Source: Real Property/California Title Insurance Practice/11 Theories and Defenses in Title Company Actions/§11.26 4. Miscellaneous Conduct

§11.26 4. Miscellaneous Conduct

- Alleged misrepresentations in pre-contract negotiations. *Paper Savers, Inc. v Nacsa* (1996) 51 CA4th 1090, 59 CR2d 547; *Desai v Farmers Ins. Exch.* (1996) 47 CA4th 1110, 55 CR2d 276; *Hess & Eureka Chem. Co. v Transamerica Occidental Life Ins. Co.* (1987) 190 CA3d 941, 945, 235 CR 715; *Gibson v Government Employees Ins. Co.* (1984) 162 CA3d 441, 447, 208 CR 511. See discussion in §13.18.
- Filing a declaratory relief action or interpleader. *Kelly v Farmers Ins. Exch.* (1987) 194 CA3d 1, 239 CR 259; *Atlas Assur. Co. v McCombs Corp.* (1983) 146 CA3d 135, 150, 194 CR 66; *Safeco Ins. Co. v Kartsone* (CD Cal 1981) 510 F Supp 856, 859. See §11.15.
- The insurer's conduct in defending itself against the insured's lawsuit. *California Physicians' Serv. v Superior Court* (1992) 9 CA4th 1321, 1330, 12 CR2d 95; *Nies v National Auto. & Cas. Ins. Co.* (1988) 199 CA3d 1192, 1200, 245 CR 518. See §11.17.

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§11.27 E. Bad Faith Handling of Claim During Litigation

An insurer's duty of good faith toward the insured continues even if the insured sues the insurer in an action on the policy. *White v Western Title Ins. Co.* (1985) 40 C3d 870, 885, 221 CR 509. In *White,* the California Supreme Court held that two settlement offers made by the insurer after suit was filed against it by the insured were admissible in evidence to demonstrate bad faith. The court noted that, although Evid C §1152 precludes evidence of settlement offers to prove liability, §1152 does not preclude the introduction of settlement negotiations if offered to prove failure to process the claim fairly and in good faith rather than to prove liability for the original loss. The court also held that CCP §998, which bars §998 settlement offers in evidence at trial, did not preclude evidence of the settlement offers, construing §998 to bar introduction of evidence of a settlement offer for the purpose of proving liability but not barring its introduction to prove another matter at issue.

Notably, the *White* opinion upheld the admissibility of settlement offers that were made after the insured had filed a lawsuit alleging breach of contract, but before the insured had stated a cause of action for bad faith. Further, the court excluded a third settlement offer made by the insurer after a summary judgment established the insurer's liability under the policy. In a footnote, the court noted that once liability was established, the insurer's willingness to offer a reasonable settlement added little weight toward proving that the insurer had been acting fairly and in good faith. 40 C3d at 889 n12.

Attempts to expand the supreme court's admission of postlitigation settlement offers have met with little success at the appellate level. For example, in *Nies v National Auto. & Cas. Ins. Co.* (1988) 199 CA3d 1192, 1200, 245 CR 518, the insured was allowed at trial to introduce into evidence the insurer's responsive pleadings in a bad faith case. The appellate court reversed a judgment in the insured's favor, finding that the responsive pleadings had been improperly admitted. The court noted that the responsive pleadings had been offered for the sole purpose of proving that the insurer acted in bad faith before paying uninsured motorist benefits. Notably, the insurer had initially denied the uninsured motorist claim and later conducted legal research, which caused it to change its position. In the interim, the insured had filed a bad faith lawsuit. The insurer then paid the uninsured motorist policy limits before filing its responsive pleadings. The *Nies* court noted that no evidence was presented that the insured had been damaged as a result of the insurer's purported bad faith litigation tactics. The court concluded that allowing the insured to introduce the insurer's responsive pleadings would "disable" the insurer from conducting a vigorous defense in a bad faith action if its pleadings were used to prove preexisting bad faith.

Also, in *California Physicians' Serv. v Superior Court* (1992) 9 CA4th 1321, 12 CR2d 95, the appellate court rejected an attempt to introduce evidence of the insurer's responsive pleadings in a bad faith action. The court held that allegedly frivolous affirmative defenses asserted by the insurer were protected by the privilege for publications made in the course of judicial proceedings. CC §47(b). See also CCP §128.7, providing that such frivolous defenses would be subject to sanctions by statutory criteria rather than by common law bad faith standards.

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§11.28 F. Bad Faith Refusal to Quiet Title

A title insurer that unjustifiably refuses to take appropriate affirmative action to establish title, as insured, when required by the language of the policy and when requested to do so by the insured, violates the covenant of good faith and fair dealing. *Jarchow v Transamerica Title Ins. Co.* (1975) 48 CA3d 917, 941, 122 CR 470, overruled on other grounds in 184 CA3d at 434. In *Jarchow,* a claimed easement, which was not discovered by the insured owners until after the close of escrow, was not exempt from coverage by any term of the title policy. The policy required the insurer to take without undue delay "such action as may be appropriate to establish the title" with respect to the alleged easement. 48 CA3d at 941. When the owners requested the insurer to remove the cloud on their title resulting from the easement, the insurer refused initially to take any action. The owners sued both the party claiming the easement and the title insurer in one action. During trial, the insurer obtained a quitclaim deed from the holder of the easement, but it was not enough to exculpate the insurer from liability for a breach of the covenant of good faith and fair dealing. 48 CA3d at 944.

PRACTICE TIP: Policies issued after *Jarchow* allow the insurer several options in responding to a notice of claim, instead of requiring the insurer to prosecute a quiet title action. See §§12.47, 12.52-12.58. However, the bad faith analysis in the decision retains its vitality for any policy that requires a title insurer to take affirmative action to quiet title on the insured's behalf. *Jarchow* underscores the importance of comparing the policy language in the reported cases with any policy counsel is reviewing on a client's behalf. Also, the enactment of Ins C §12340.11 changed the effect of the *Jarchow* decision with respect to the current viability of a claim for negligent preparation of a preliminary report (see §§11.42-11.44).

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§11.29 G. Statutory Claims

Insurance Code §790.03 defines 7 categories of prohibited unfair or deceptive acts or practices and 16 unfair claims settlement practices. In *Royal Globe Ins. Co. v Superior Court* (1979) 23 C3d 880, 153 CR 842, the California Supreme Court held that a third party claimant on a liability policy could sue an insurer under Ins C §790.03(h) for damages caused by the insurer's unfair claims settlement practices. But in *Moradi-Shalal v Fireman's Fund Ins. Cos.* (1988) 46 C3d 287, 250 CR 116, the supreme court overruled *Royal Globe*, thus eliminating a private cause of action by a third party based on §790.03.

Subsequent appellate decisions have held that *Moradi-Shalal* also abolished a statutory cause of action brought by a "first party," *i.e.*, an insured. See, *e.g.*, *Zephyr Park, Ltd. v Superior Court* (1989) 213 CA3d 833, 837, 262 CR 106; *Industrial Indem. Co. v Superior Court* (1989) 209 CA3d 1093, 1097, 257 CR 655.

Moradi-Shalal was applied prospectively only to bar actions filed after the decision became final on October 17, 1988. Thus, except for claims filed before that date, a private cause of action based on Ins C §790.03 is of primarily historical interest. Nevertheless, appellate decisions reported after *Moradi-Shalal* continue to rule that §790.03 is a codification of common law duties of good faith and fair dealing and thus sets a statutory standard of conduct against which an insurer's conduct should be measured in the prosecution of the common law tort. See, *e.g.*, *Twaite v Allstate Ins. Co.* (1989) 216 CA3d 239, 254, 264 CR 598; *Industrial Indem. Co. v Superior Court* (1989) 209 CA3d 1093, 1097, 257 CR 655. However, a cause of action for breach of the covenant of good faith and fair dealing derived from the standards in §790.03 are available only to an insured and not to a third party claimant. 209 CA3d at 1097.

The unfair claims settlement practices prohibited by Ins C §790.03(h) have been expanded in the unfair claims settlement practices regulations, 10 Cal Code Regs §§2695.1-2695.14. It remains to be seen whether these regulations will serve as the basis for a regulatory standard of good faith. For further discussion of Ins C §790.03, see California Liability Insurance Practice: Claims & Litigation §§28.32-28.40 (Cal CEB 1991).

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§11.30 H. Damages Recoverable

An action for breach of the covenant of good faith and fair dealing "sounds both in contract and tort," and a successful insured may recover all available tort damages, including all damages proximately caused by the insurer's breach. CC §3333; *Crisci v Security Ins. Co.* (1967) 66 C2d 425, 433, 58 CR 13. In contrast, on proof of a breach of contract, the successful party is entitled only to damages that the parties contemplated at the formation of the contract. *California Shoppers, Inc. v Royal Globe Ins. Co.* (1985) 175 CA3d 1, 57, 221 CR 171.

When both contract and bad faith tort theories are the subject of a trial, the jury must be instructed separately on each theory; to do otherwise is reversible error. 175 CA3d at 64. For a general discussion of damages recoverable from general liability insurers in bad faith actions, see California Liability Insurance Practice: Claims & Litigation §§24.68-24.88 (Cal CEB 1991).

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§11.31 1. Emotional Distress Damages

Although an insured may not recover damages for emotional distress under a cause of action for breach of contract, the insured may, on proper proof, recover such damages under a bad faith cause of action. *Gruenberg v Aetna Ins. Co.* (1973) 9 C3d 566, 579, 108 CR 480. Emotional distress damages in such cases are recovered in essence as an aggravation of the financial loss suffered by the insured. *Crisci v Security Ins. Co.* (1967) 66 C2d 425, 433, 58 CR 13.

If the insured suffered no economic loss or no invasion of property rights to which the alleged emotional distress could be attached, then no basis exists for a bad faith claim or an award of emotional distress damages. *Nager v Allstate Ins. Co.* (2000) 83 CA4th 284, 291, 99 CR2d 348; *Maxwell v Fire Ins. Exch.* (1998) 60 CA4th 1446, 1447, 70 CR2d 866 (loss of use of money during 81-day delay in payment of balance of judgment did not meet threshold requirement of economic loss); *Waters v United Servs. Auto. Ass'n* (1996) 41 CA4th 1063, 1078, 48 CR2d 910; *Continental Ins. Co. v Superior Court* (1995) 37 CA4th 69, 85, 43 CR2d 374; *Blake v Aetna Life Ins. Co.* (1979) 99 CA3d 901, 160 CR 528. See also *Clayton v United Servs. Auto. Ass'n* (1997) 54 CA4th 1158, 1161, 63 CR2d 419 (when any economic loss is shown, insured may recover for all emotional distress caused by insurer's bad faith without having to prove that emotional distress was caused by economic loss). The insured need not prove that the insurer's conduct was "extreme and outrageous" as is required in a cause of action for intentional infliction of emotional distress. *Gruenberg v Aetna Ins. Co.* (1973) 9 C3d 566, 578, 108 CR 480.

Some appellate decisions have held that the insured must show that the emotional distress was "severe, substantial or enduring." *Twaite v Allstate Ins. Co.* (1989) 216 CA3d 239, 257, 264 CR 598; *Commercial Cotton Co. v United Cal. Bank* (1985) 163 CA3d 511, 516, 209 CR 551; *Young v Bank of America* (1983) 141 CA3d 108, 114, 190 CR 122. These authorities indicate that feelings of anger, irritation, or aggravation are insufficient to support an award of emotional distress damages. *Twaite v Allstate Ins. Co., supra*; *Commercial Cotton Co. v United Cal. Bank, supra*. But see *Clayton v United Servs. Auto. Ass'n* (1997) 54 CA4th 1158, 1162, 63 CR2d 419 (emotional distress need not be severe or substantial to be compensable); *Fletcher v Western Nat'l Life Ins. Co.* (1970) 10 CA3d 376, 397, 89 CR 78 (compensable emotional distress includes fright, grief, shame, humiliation, embarrassment, anger, chagrin, disappointment, or worry); *Pershing Park Villas Homeowners Ass'n v United Pac. Ins. Co.* (9th Cir 2000) 219 F3d 895, 904.

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§11.32 2. Consequential Economic Loss

Once an insured has proved bad faith conduct by the insurer, the insured may seek to recover past and future economic losses proximately caused by the breach that can be established with reasonable certainty. *Egan v Mutual of Omaha Ins. Co.* (1979) 24 C3d 809, 824 n7, 169 CR 691; *California Shoppers, Inc. v Royal Globe Ins. Co.* (1985) 175 CA3d 1, 62, 221 CR 171.

The type of economic loss that may be recovered depends on the facts of the particular case. See *Bodenhamer v Superior Court* (1987) 192 CA3d 1472, 1477, 1479, 238 CR 177 (lost business profits and damage to good will); *Barney v Aetna Cas. & Sur. Co.* (1986) 185 CA3d 966, 981, 230 CR 215 (losses to insured caused by insurer settling claim with third party without consent of insured, which barred insured's cross-claim); *Larraburu Bros. v Royal Indem. Co.* (9th Cir 1979) 604 F2d 1208, 1215 (damage to business's financial reputation with lenders; California law applied).

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§11.33 3. Prejudgment Interest

Although an insured can more easily recover prejudgment interest under a breach of contract cause of action under CC §3287, it is more limited in a bad faith action. For example, an insured may seek to recover prejudgment interest under CC §3288 in a tort claim based on a showing of oppression, fraud, or malice. Such an award is in the jury's discretion and cannot be based on "intangible, non-economic" damages such as mental or emotional injury. *Greater Westchester Homeowners' Ass'n v City of Los Angeles* (1979) 26 C3d 86, 102, 160 CR 733.

Prejudgment interest, however, cannot be awarded under CC §3291 in a cause of action for bad faith. The courts have characterized a claim for bad faith as a claim for invasion of property rights, not a claim for "personal injury" within the meaning of §3291. *Pilimai v Farmers Ins. Exch. Co.* (2006) 39 C4th 133, 146, 45 CR3d 760; *Gourley v State Farm Mut. Auto. Ins. Co.* (1991) 53 C3d 121, 123, 3 CR2d 666.

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§11.34 4. Attorney Fees and Litigation Expenses

When an insurer's bad faith conduct compels the insured to incur attorney fees and other litigation expenses to recover amounts due under the policy, the insured may seek to recover those fees and expenses. *Brandt v Superior Court* (1985) 37 C3d 813, 817, 210 CR 211; *Cassim v Allstate Ins. Co.* (2004) 33 C4th 780, 806, 16 CR3d 374. See also *Essex Ins. Co. v Five Star Dye House, Inc.* (2006) 38 C4th 1252, 1255, 45 CR3d 362. Only fees and expenses incurred to prove entitlement to policy benefits are recoverable, however; fees or expenses allocable to proof of any other portion of the plaintiff's claims or damages are not. *Brandt,* 37 C3d at 819; *Cassim,* 33C4th at 806. Similarly, in a successful bad faith claim involving title insurance, *White v Western Title Ins. Co.* (1985) 40 C3d 870, 890, 221 CR 509, the supreme court held that the insured was entitled to recover witness fees and other litigation expenses incurred to prove entitlement to policy benefits. See also *Track Mortgage Group, Inc. v Crusader Ins. Co.* (2002) 98 CA4th 857, 867, 120 CR2d 228; CACI 2350 (plaintiff may recover attorney fees incurred to obtain policy benefits but not attorney fees incurred for other purposes). In *Essex Ins. Co. v Five Star Dye House, Inc*. (2006) 38 C4th 1252, 1265 n4, 45 CR3d 362, the supreme court disapproved *Xebec Dev. Partners, Ltd. v National Union Fire Ins. Co*. (1993) 12 CA4th 501, 15 CR2d 726, and held that an assignee of an insured's bad faith cause of action may recover *Brandt* fees.

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§11.35 5. Punitive Damages

Punitive damages are not available for breach of contract. CC §3294(a). However, a cause of action for bad faith sounds in both contract and tort. *Gruenberg v Aetna Ins. Co.* (1973) 9 C3d 566, 573, 108 CR 480. Thus punitive damages are potentially available if the insured can demonstrate bad faith, but proof of bad faith alone does not entitle the insured to an award of punitive damages. Although the same evidence may be relevant to prove breach of contract, bad faith, and malice, fraud, or oppression, an award of punitive damages is far from automatic even on a finding of bad faith. *Beck v State Farm Mut. Auto. Ins. Co.* (1976) 54 CA3d 347, 355, 126 CR 602.

Punitive damages are appropriate "when the tortious conduct rises to levels of extreme indifference to the plaintiff's rights, a level which decent citizens should not have to tolerate." *Tomaselli v Transamerica Ins. Co.* (1994) 25 CA4th 1269, 1287, 31 CR2d 433. However, punitive damages should not be allowed when the offending conduct is consistent with "a mistake of law or fact, honest error of judgment, over-zealousness, mere negligence or other such noniniquitous human failing." 25 CA4th at 1288 n14. See also *Patrick v Maryland Cas. Co.* (1990) 217 CA3d 1566, 1576, 267 CR 24 (claims handling that is "witless and infected with symptoms of bureaucratic inertia and inefficiency" does not constitute malicious or oppressive behavior requiring imposition of punitive damages). Thus, a "marginally sufficient case of bad faith is not likely to prove malice or oppression by clear and convincing evidence." *Shade Foods, Inc. v Innovative Prods. Sales & Mktg., Inc*. (2000) 78 CA4th 847, 909, 93 CR2d 364.

To support an award of punitive damages, the insured must establish three basic levels of proof:

- First, the insured must demonstrate entitlement to policy benefits;
- Second, the insured must prove that the insurer's conduct amounted to "bad faith";
- Third, the insured must establish that the insurer's conduct constituted "oppression," "malice," or "fraud" within the meaning of CC §3294. In other words, the insured must make a distinct showing that the insurer acted with intent to vex, injure, or annoy, or with a conscious disregard of the rights of the insured. *Beck*, 54 CA3d at 355.

Finally, after the threshold levels of proof are made, the insured is required to introduce evidence establishing the defendant's financial condition. *Tomaselli,* 25 CA4th at 1282.

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§11.35A a. Clear and Convincing Evidence

Civil Code §3294(a), applied in the title insurance context, requires the insured to prove, by clear and convincing evidence, that the insurer is guilty of oppression, fraud, or malice. This higher "clear and convincing" evidentiary standard also applies to summary judgment or summary adjudication motions challenging punitive damage claims (*Jordan v Allstate Ins. Co.* (2007) 148 CA4th 1062, 1080, 56 CR3d 312; *Basich v Allstate Ins. Co.* (2001) 87 CA4th 1112, 1118, 105 CR2d 153) and to motions for nonsuit challenging a claim for punitive damages (*Stewart v Truck Ins. Exch.* (1993) 17 CA4th 468, 481, 21 CR2d 338).

NOTE: Under CC §3294(b), a corporate defendant may be held liable for punitive damages if the plaintiff proves that an officer, director, or managing agent of the defendant authorized or ratified the wrongful conduct for which the damages are awarded. Judicial Council of California Civil Jury Instruction 3943 and related instructions have been modified to reflect the holding in *Barton v Alexander Hamilton Life Ins. Co.* (2003) 110 CA4th 1640, 1644, 3 CR3d 258, that such authorization or ratification must be proved by clear and convincing evidence. Punitive damage cases decided under the pre-1987 law may be distinguishable on that basis. See, *e.g., Hughes v Blue Cross of N. Cal.* (1989) 215 CA3d 832, 263 CR 850; *Downey Sav. & Loan Assn. v Ohio Cas. Ins. Co.* (1987) 189 CA3d 1072, 234 CR 835; *Delgado v Heritage Life Ins. Co.* (1984) 157 CA3d 262, 203 CR 672; *Moore v American United Life Ins. Co.* (1984) 150 CA3d 610, 197 CR 878. While such cases continue to be valid examples of conduct that constitute bad faith (which requires proof by a preponderance of the evidence), attorneys should carefully consider whether they remain valid authorities regarding what conduct constitutes "malice," "fraud," or "oppression."

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§11.35B b. Constitutionality of Punitive Damages

Under California law, a punitive damage award must be based on three factors: (1) the reprehensibility of the defendant's conduct; (2) the amount of compensatory damages awarded to, or actual harm suffered by, the plaintiff; and (3) the defendant's financial condition. *Adams v Murakami* (1991) 54 C3d 105, 110, 284 CR 318; *Neal v Farmers Ins. Exch.* (1978) 21 C3d 910, 928, 148 CR 389. However, more recent cases appear to have shifted the focus to federal due process standards.

Several recent cases have dealt with the constitutionality of punitive damage awards under federal standards. In *State Farm Mut. Auto. Ins. Co. v Campbell* (2003) 538 US 408, 155 L Ed 2d 585, 123 S Ct 1513, the United States Supreme Court held that the due process clause of the 14th Amendment prohibits grossly excessive or arbitrary punishment of a tortfeasor and therefore limits the amount of punitive damages that a state court can award. The *State Farm* court required courts reviewing a punitive damage award to evaluate whether the award of punitive damages was excessive in light of the following "guideposts":

- The degree of reprehensibility of the defendant's conduct;
- The disparity between the actual or potential harm suffered by the plaintiff and the punitive damages awarded; and
- The difference between the punitive damages awarded by the jury and penalties authorized or imposed in comparable cases.

The first two guideposts are appropriate for a jury to consider in determining the amount of a punitive damages award. The third guidepost is appropriate only for a reviewing court to consider. *Bullock v Philip Morris USA, Inc.* (2008) 159 CA4th 655, 689, 71 CR3d 775; *Century Sur. Co. v Polisso* (2006) 139 CA4th 922, 959, 43 CR3d 468.

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§11.35C (1) First Guidepost: Reprehensibility of Defendant's Conduct

In *State Farm Mut. Auto. Ins. Co. v Campbell* (2003) 538 US 408, 419, 155 L Ed 2d 585, 602, 123 S Ct 1513, the Supreme Court explained that the reprehensibility of the defendant's conduct is the "most important indicium of the reasonableness of a punitive damages award." See also *BMW of N. Am. v Gore* (1996) 517 US 559, 575, 134 L Ed 2d 809, 826, 116 S Ct 1589. The issue of reprehensibility requires the court to examine:

- Whether the harm caused was physical as opposed to economic;
- Whether the tortious conduct evinced an indifference to, or a reckless disregard of, the health or safety of others;
- Whether the target of the conduct had financial vulnerability;
- Whether the conduct involved repeated actions or was an isolated incident; and
- Whether the harm was the result of intentional malice, trickery, or deceit, or mere accident.

Repeated misconduct is more reprehensible than an individual act of malfeasance. 538 US at 423; *Johnson v Ford Motor Co.* (2005) 35 C4th 1191, 1202, 29 CR3d 401. Similar conduct need not be identical, but courts must ensure that it "replicate the prior transgressions." *Johnson,* 35 C4th at 1204. Evidence of wide-ranging, dissimilar business practices cannot be used to show reprehensibility, because "a defendant should be punished for the conduct that harmed the plaintiff, not for being an unsavory individual or business." *State Farm,* 538 US at 421. However, a refusal to defend an insured may be considered more than a single event, if it consists of a series of acts or course of conduct committed over a period of time. *Century Sur. Co. v Polisso* (2006) 139 CA4th 922, 965, 43 CR3d 468.

A jury may consider evidence of harm to others in determining the degree of reprehensibility of the defendant's conduct. *Philip Morris USA v Williams* (2007) 549 US 346, 355, 166 L Ed 2d 940, 949, 127 S Ct 1057. However, a state court may not award punitive damages for the purpose of punishing a defendant for harm caused to nonparties to the litigation. 549 US at 353, L Ed 2d at 948. Because evidence of harm to nonparties may be admitted for the limited purpose of determining reprehensibility, but may not be used for the purpose of determining the amount of punitive damages, a California appellate court held that it was error to refuse to give the following instruction requested by the defendant: "You are not to impose punishment for harms suffered by persons other than the plaintiff before you." *Bullock v Philip Morris USA, Inc.* (2008) 159 CA4th 655, 693, 71 CR3d 775.

PRACTICE TIP: Although the court in *Bullock* held that the defendant did not need to qualify this instruction to reflect permitted uses of evidence of harm to others, the court noted that "a specific instruction encompassing both the permitted and prohibited uses of evidence of harm caused to others would be appropriate." 159 CA4th at 695 n21. The court summarized the distinction between permitted and prohibited uses of such evidence (159 CA4th at 695 n21):

> A jury may consider evidence of harm caused to others for the purpose of determining the degree of reprehensibility of a defendant's conduct toward the plaintiff in deciding the amount of punitive damages, but it may not consider that evidence for the purpose of punishing the defendant directly for harm caused to others.

The court did not expressly frame this as a proposed jury instruction, but it would appear to be an appropriate starting place for counsel drafting a special jury instruction on this issue.

Further, a defendant cannot be punished for its conduct in other states that is lawful in those states and that does not impact the plaintiff. *BMW of N. Am. v Gore* (1996) 517 US 559, 572, 134 L Ed 2d 809, 824, 116 S Ct 1589. However, evidence describing out-of-state transactions may be relevant to the determination of the degree of reprehensibility of the defendant's conduct. 517 US at 574 n21, 134 L Ed 2d at 825 n21.

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§11.35D (2) Second Guidepost: Disparity Between Harm Suffered by Plaintiff and Punitive Damages Awarded

In *State Farm,* the United States Supreme Court declined to establish a bright-line, mathematical formula or ratio of punitive to compensatory damages, but did explain that although awards generally will not exceed a single-digit ratio between punitive and compensatory damages, a particularly egregious act which results in a small amount of economic damages may permit a higher ratio. The Court further explained that conversely, when compensatory damages are substantial, a lesser ratio—perhaps only 1:1—can reach the outermost limit of the constitutional guarantee. *State Farm*, 528 US at 426.

California courts following *State Farm* have demonstrated that the numerical ratio discussed will not be rigidly followed. For example, in *Simon v San Paolo U.S. Holding Co., Inc.* (2005) 35 C4th 1159, 29 CR3d 379, the California Supreme Court disagreed with the statement in *Diamond Woodworks, Inc. v Argonaut Ins. Co.* (2003) 109 CA4th 1020, 1057, 135 CR2d 736 that, "in the usual case," the United States Supreme Court's decisions establish an "outer constitutional limit" of approximately four times the compensatory damages. The *Simon* court stated (35 C4th at 1182):

> We understand the court's statement in *State Farm* [*v Campbell, supra*] that "few awards" significantly exceeding a single-digit ratio will satisfy due process to establish a type of presumption: ratios between the punitive damages award and the plaintiff's actual or potential compensatory damages significantly greater than nine or 10 to one are suspect and, absent special justification (by, for example, extreme reprehensibility or unusually small, hard-to-detect or hard-to-measure compensatory damages), cannot survive appellate scrutiny under the due process clause.

The *Simon* court went on to hold that a punitive damage award of 340 times the compensatory damage award qualified as a "breathtaking" multiplier far outside the "single-digit neighborhood" suggested by *State Farm*. The *Simon* court ruled that when an award of punitive damages is constitutionally excessive, the appropriate order is for an absolute reduction, rather than a conditional reduction with the alternative of a new trial. 35 C4th at 1187. In *Simon,* the court reduced the punitive damages to $50,000, just exceeding the largest single-digit ratio amount, which the court stated was "not extraordinary for fraudulent conduct," but not so minor that it could be "completely ignored by the defendant" because even a prosperous company would ordinarily take measures to prevent the recurrence of a $50,000 net loss. *Simon,* 35 C4th at 1189.

In *Textron Fin. Corp. v National Union Fire Ins. Co.* (2004) 118 CA4th 1061, 1084, 13 CR3d 586, the appellate court held that the second "guidepost," consideration of the disparity between a plaintiff's actual harm and the punitive damage award, must be limited to the amount awarded for the tort claims supporting the punitive damage, and exclude any sum the plaintiff received for breach of contract. See also California Real Property Sales Transactions §13.118 (4th ed Cal CEB 2007).

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§11.35E (3) Third Guidepost: Difference Between Punitive Damages Awarded and Penalties Authorized in Comparable Cases

Although the "third guidepost" requires a court review of the difference between the punitive damages awarded by the jury and penalties authorized or imposed in comparable cases, in *Century Sur. Co. v Polisso* (2006) 139 CA4th 922, 959, 43 CR3d 468, the appellate court held this was not intended to be a factor for the jury's consideration. The court, therefore, found no error in the use of BAJI 14.72.2, which does not address comparable civil sanctions, nor was it error to reject a special jury instruction on that issue. In addition, the court held evidence of civil sanctions was irrelevant for the jury's consideration and was properly excluded. 139 CA4th at 958. Further, in its review of the punitive damage award, the appellate court held that the maximum $10,000 fine imposed by Ins C §790.035 for each willful act of insurer misconduct was "not particularly useful" when the insurer engaged in a course of conduct over a 5-year period that involved many prohibited acts. 139 CA4th at 967.

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§11.35F (4) Aggregate Disgorgement of Profits Theory Prohibited

In *Johnson v Ford Motor Co.* (2005) 35 C4th 1191, 29 CR3d 401, the court held that an award of punitive damages may not be based on an aggregate disgorgement of profits theory. Repeated acts of similar misconduct and the profitability of that conduct is relevant to the issue of reprehensibility, and disgorgement of profits earned from the wrongful act committed against the plaintiff is permissible. However, calculating punitive damages in an individual tort case by the profits the defendant made through similar torts against hundreds or thousands of other individuals "creates possibilities for unfairness—to the defendant and other possible claimants both—which may be of constitutional dimension." 35 C4th at 1208.

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§11.35G (5) Evidence of Defendant's Net Worth Required

To serve the goals of punishment and deterrence, a punitive damage award must be large enough to deter future bad conduct, without exceeding the amount necessary for punishment. *Century Sur. Co. v Polisso* (2006) 139 CA4th 922, 967, 43 CR3d 468; *Simon v San Paolo U.S. Holding Co., Inc.* (2005) 35 C4th 1159, 1185, 29 CR3d 379; *Wysinger v Automobile Club of S. Cal.* (2007) 157 CA4th 413, 429, 69 CR3d 1. Thus, in *Century Surety*, the court held that evidence of the defendant's net worth was an essential factor in the punitive damage phase of the trial. 139 CA4th at 960. See also CC §3295(d); *Adams v Murakami* (1991) 54 C3d 105, 110, 284 CR 318. Further, the court found that a punitive damage award of 3.2 percent of the defendant's net worth was appropriate, because a smaller award "would not amount to much more than a slap on the wrist." 139 CA4th at 967. See also *Bardis v Oates* (2004) 119 CA4th 1, 26, 14 CR3d 89 (punitive damage award of less than 1 percent of defendant's net worth "tantamount to a slap on the wrist").

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§11.36 c. Examples: Punitive Damages Allowed

Although a review of all the different types of conduct by an insurer that has been found to support an award of punitive damages is beyond the scope of this work, an award of punitive damages has been upheld in the following circumstances:

- The insurer improperly denied a defense then defended under reservation of rights but refused to allow *Cumis* counsel. After allowing *Cumis* counsel, the insurer failed to pay counsel's bills. The insurer then used a declaratory relief action against the insured as "leverage" and as a "negotiating tool." The court held that this constituted a course of conduct designed to avoid paying for defense. *Century Sur. Co. v Polisso* (2006) 139 CA4th 922, 964, 43 CR3d 468. See §12.50 for a discussion of *Cumis* counsel.
- An unreasonable delay in claim processing and the denial of a claim for the failure to report a theft within 48 hours supported a punitive damages award. The company's claims department was staffed by two people with no claims experience, had no procedures for handling claims, and never investigated the claim or the insured's reason for delay in reporting the claim. The policy also contained a misrepresentation that the insured would be named as an additional insured in another policy. *Campbell v Cal-Gard Sur. Servs., Inc.* (1998) 62 CA4th 563, 570, 73 CR2d 64.
- A receiver was entitled to punitive damages when the insurer acted with malice, oppression, or fraud by, independently and through adoption of the independent adjuster's conduct, intentionally concealing and misrepresenting an important fact, failing to investigate the claim, and failing to pay policy benefits in bad faith. *Baron v Fire Ins. Exch.* (2007) 154 CA4th 1184, 65 CR3d 502.
- A bad faith refusal to defend under a policy was found to constitute "oppression" but not malice or fraud, even though the court characterized the refusal to defend as an "isolated incident" and the product of "oversight and a mistake." *Walker v Farmers Ins. Exch.* (2007) 153 CA4th 965, 63 CR3d 507.
- Defendant's failure to estimate reasonable claim reserve levels resulted in plaintiff's paying higher premiums and receiving lower dividends. The insurer also engaged in widespread unfair and bad faith business practices, including deceit, cover-up, and fraud. Defendant had changed its policy for determining adequate reserves from one of "realistic and reasonably anticipated final cost" to one that defined adequate reserves as the "maximum probable potential cost." *Notrica v State Comp. Ins. Fund* (1999) 70 CA4th 911, 947, 83 CR2d 89.
- A court found widespread business practices that fell below industry standards and were intentionally designed to prevent insureds from receiving benefits. The practices included misrepresenting benefits available to the insured, the failure to adopt reasonable standards for processing claims, the failure to settle claims in good faith, the failure to inform insureds of all benefits available under policies, and the targeting of claims for termination. *Hangarter v Paul Revere Life Ins. Co.* (9th Cir 2004) 373 F3d 998.

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§11.37 d. Examples: Punitive Damages Denied

As with punitive damages that have been allowed, a review of all the different types of conduct by an insurer that has been found not to rise to the level of malice, fraud, or oppression sufficient to support an award of punitive damages is beyond the scope of this work. However, the following cases are examples of factual circumstances in which the courts held that punitive damages were not warranted:

- The jury found that the title insurer committed bad faith for failing to prosecute a quiet title action, but specifically found no malice, oppression, or fraud. *Jarchow v Transamerica Title Ins. Co.* (1975) 48 CA3d 917, 925, 122 CR 470, overruled on other grounds in 184 CA3d at 434.
- Unexplained delays in investigating a claim constituted bad faith but did not establish malice, fraud, or oppression sufficient to support an award of punitive damages. "While [the insurer's] investigation could possibly have been pursued with more vigor, it was nonetheless pursued, not ignored." *Stewart v Truck Ins. Exch.* (1993) 17 CA4th 468, 483, 21 CR2d 338.
- Misrepresentation or breach of fiduciary duty without malice, fraud, or oppression is insufficient to support an award of punitive damages. However, punitive damages were awarded for fraud. *Delos v Farmers Group, Inc.* (1979) 93 CA3d 642, 656, 155 CR 843.
- Delays in appointing competent defense counsel and a stated eagerness to limit defense costs amounted to bad faith, but did not support an award of punitive damages. The evidence established the insurer's reluctance to defend the case, but it was not sufficient to establish that the insurer knew that its conduct would leave the insured unprepared for trial or that it willfully disregarded that adverse consequence as it proceeded with the defense. *Travelers Ins. Co. v Lesher* (1986) 187 CA3d 169, 200, 231 CR 791, disapproved on other grounds in *Buss v Superior Court* (1997) 16 C4th at 50 n12, 52 n14.
- Assertion of a "patently untenable" defense based on advice of counsel is insufficient to support an award of punitive damages, although it did support a finding of bad faith. Proof of breach of the duty of good faith and fair dealing does not establish that the insurer acted with intent to injure the insured. *Beck v State Farm Mut. Auto. Ins. Co.* (1976) 54 CA3d 347, 355, 126 CR 602.
- Evidence that the insurer had unqualified persons review the claim and reduced the frequency of psychotherapy sessions for the insured supported a finding of bad faith but not an award of punitive damages. *Weisman v Blue Shield* (1984) 163 CA3d 61, 66, 209 CR 169.
- Taking an unnecessary deposition of the insured under oath did not support an award of punitive damages. *Tomaselli v Transamerica Ins. Co.* (1994) 25 CA4th 1269, 1288, 31 CR2d 433.
- Negligent or "shoddy" claims handling, including failure to follow up on information provided by the insured, and even a "callous" failure to communicate with the insured, were insufficient to justify punitive damages. *Tomaselli v Transamerica Ins. Co.* (1994) 25 CA4th 1269, 1288, 31 CR2d 433; *Patrick v Maryland Cas. Co.* (1990) 217 CA3d 1566, 1576, 267 CR 24.
- Failure to reconsider an ill-advised coverage denial, and an obstinate persistence in the ill-advised initial position, found to constitute conduct that "falls within the common experience of human affairs, both with respect to its careless initial evaluation and its stubborn persistence in error," and therefore insufficient to constitute "despicable" conduct necessary to impose punitive damages. *Shade Foods, Inc. v Innovative Prods. Sales & Mktg., Inc.* (2000) 78 CA4th 847, 879, 93 CR2d 364.

Defenses to punitive damage claims are discussed in §§11.107-11.111.

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IV. OTHER THEORIES OF LIABILITY

§11.38 A. Negligent Preparation of Abstract

Historically, when a title insurer presented a buyer with both a "preliminary title report" and a "title insurance policy," the law held that the title insurer had assumed two distinct responsibilities. The preliminary title report was considered an abstract of title, and the insurer was held liable for negligent failure to list and accurately describe all matters of public record regarding the property. See, *e.g.*, *Jarchow v Transamerica Title Ins. Co.* (1975) 48 CA3d 917, 938, 122 CR 470, overruled on other grounds in 184 CA3d at 434; *Hawkins v Oakland Title Ins. & Guar. Co.* (1958) 165 CA2d 116, 126, 331 P2d 742; *J. H. Trisdale, Inc. v Shasta County Title Co.* (1956) 146 CA2d 831, 837, 304 P2d 832.

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§11.39 1. Preliminary Report Distinguished

In 1982, legislation clarified for future transactions that an abstract of title and a preliminary report are two separate and distinct features of title insurance. Ins C §§12340.10-12340.11. The term "title" was dropped from the name "preliminary report," and its basic function was redefined in Ins C §12340.11. See discussion in §§5.25-5.29, 13.4. Although a title insurer's potential liability for negligent preparation of a preliminary report has now been curtailed (Ins C §12340.11), if a title insurer prepares a "true" abstract of title, the insurer remains potentially liable for negligent preparation of that abstract. *Siegel v Fidelity Nat'l Title Ins. Co.* (1996) 46 CA4th 1181, 1194, 54 CR2d 84. An abstract of title is now defined in Ins C §12340.10:

> "Abstract of title" is a written representation, provided pursuant to a contract, whether written or oral, intended to be relied upon by the person who has contracted for the receipt of such representation, listing all recorded conveyances, instruments or documents which, under the laws of this state, impart constructive notice with respect to the chain of title to the real property described therein. An abstract of title is not a title policy as defined in [Ins C §]12340.2.

As a rule, title insurance companies no longer provide abstract services. In the rare cases of abstracts being prepared, or late discovery of claims arising from abstracts prepared before such services were phased out, the same standards apply as before Ins C §§12340.10-12340.11 were enacted. If the abstract fails to list a matter of public record on the property, the insured may seek recovery either in contract or in tort. *Northwestern Title Sec. Co. v Flack* (1970) 6 CA3d 134, 146, 85 CR 693.

The insured is entitled to rely on the abstract as a true representation of title to the property without personally researching the status of title to the property. *White v Western Title Ins. Co.* (1985) 40 C3d 870, 885, 221 CR 509; *J. H. Trisdale, Inc. v Shasta County Title Co.* (1956) 146 CA2d 831, 836, 304 P2d 832. An insured who does not actually rely on the abstract cannot recover, however, because the insurer's negligence in preparing the abstract was not a proximate cause of the insured's loss. *Lawrence v Chicago Title Ins. Co.* (1987) 192 CA3d 70, 77, 237 CR 264. Further, the definition of an "abstract of title" in Ins C §12340.10 specifies that it must be "intended to be relied upon by the person who has contracted" for its receipt. Thus, only the purchaser or intended third party beneficiaries may rely on the abstract of title. *Stagen v Stewart-West Coast Title Co.* (1983) 149 CA3d 114, 119, 196 CR 732 (title report and title policy were issued before §12340.10 was enacted).

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§11.40 2. Duty of Due Care

Whether based in contract or in tort, the abstractor owes a duty of due care in searching the public records and preparing its report. *Stagen v Stewart-West Coast Title Co.* (1983) 149 CA3d 114, 118, 196 CR 732; *Northwestern Title Sec. Co. v Flack* (1970) 6 CA3d 134, 146, 85 CR 693; *Hawkins v Oakland Title Ins. & Guar. Co.* (1958) 165 CA2d 116, 125, 331 P2d 742. A failure to note an encumbrance of record is prima facie negligent. *White v Western Title Ins. Co.* (1985) 40 C3d 870, 883, 221 CR 509. The abstractor must "report all matters which could affect his client's interests and which are readily discoverable from those public records ordinarily examined when a reasonably diligent title search is made." *Contini v Western Title Ins. Co.* (1974) 40 CA3d 536, 545, 115 CR 257. See also *1119 Delaware v Continental Land Title Co.* (1993) 16 CA4th 992, 1000, 20 CR2d 438; *J. H. Trisdale, Inc. v Shasta County Title Co.* (1956) 146 CA2d 831, 837, 304 P2d 832.

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§11.41 3. Damages

The measure of damages for negligent preparation of an abstract is an amount that "will compensate for all the detriment proximately caused thereby." CC §3333; *Barthels v Santa Barbara Title Co.* (1994) 28 CA4th 674, 678, 33 CR2d 579. If the insured does not actually rely on the abstract, however, such negligence is not a proximate cause of any loss to the insured. *Lawrence v Chicago Title Ins. Co.* (1987) 192 CA3d 70, 77, 237 CR 264; *Hawkins v Oakland Title Ins. & Guar. Co.* (1958) 165 CA2d 116, 125, 331 P2d 742; *Mitchell v California Pac. Title Ins. Co.* (1926) 79 CA 45, 53, 248 P 1035. Further, even if the negligently prepared abstract misleads the insured as to the value of the property, the insured cannot recover any damages which were not proximately caused by reliance on the abstract. *Barthels v Santa Barbara Title Co., supra.* In *Barthels*, the abstract indicated that the property had a 15-foot-wide access easement, but in fact it was only a 7-foot-wide easement, precluding development. Because the owner had relied on the abstract in purchasing and attempting to develop the lot, the appellate court affirmed an award against the abstractor, including the amount paid to buy the lot and reasonable expenses incurred in attempting to develop it. However, the court held that the owner could not recover the loss of economic value of the property (*i.e.*, the value of the lot without the defect minus its value with the defect) because nothing the abstractor did *caused* the lack of a sufficient access easement. 28 CA4th at 678.

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§11.42 B. Negligent Preparation of Preliminary Report

Insurance Code §12340.11 (effective Jan. 1, 1982) states:

> "Preliminary report", "commitment", or "binder" are reports furnished in connection with an application for title insurance and are offers to issue a title policy subject to the stated exceptions set forth in the reports and such other matters as may be incorporated by reference therein. The reports are not abstracts of title, nor are any of the rights, duties or responsibilities applicable to the preparation and issuance of an abstract of title applicable to the issuance of any report. Any such report shall not be construed as, nor constitute, a representation as to the condition of title to real property, but shall constitute a statement of the terms and conditions upon which the insurer is willing to issue its title policy, if such offer is accepted.

In contrast to an abstract of title, which is a written representation of the status of title to the property, a preliminary report is an offer to issue a title policy subject to the stated exceptions in the report and the preprinted exceptions and exclusions in the policy. See §11.39. A preliminary report is not a representation of the condition of title to the property. Ins C §12340.11; *Southland Title Corp. v Superior Court* (1991) 231 CA3d 530, 537, 282 CR 425. The insurer may ignore or omit a possible exception to title based on an underwriting decision. 231 CA3d at 538.

A preliminary report must include a statutory warning when the report is intended to be an offer by the insurer to issue an owner's title insurance policy. Ins C §12414.30. The purpose of this warning is to alert the prospective insured about the limitations of the preliminary report set forth in Ins C §12340.11. For an example of this warning language, see the paragraphs in bold type on the opening page of Apps C and D.

NOTE: The result of the 1982 amendments to the Insurance Code is that a recorded matter that an insured might expect to see in the specially stated exceptions of a preliminary report may be omitted there, but not be covered by the title policy, because the matter is encompassed in the more general preprinted exclusions and exceptions of the policy. Without complete, reliable information on the status of title, it is extremely difficult for a potential insured to know how to negotiate the addition of special endorsements that might be available to minimize the risk of title defects in the property about to be insured. This dilemma is compounded because, after Ins C §§12340.10-12340.11 were enacted, title companies phased out their abstract services. See §13.4.

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§11.43 1. Claim on Reports Issued Before January 1, 1982

The California Supreme Court has interpreted Ins C §12340.11 to apply prospectively only and not to preliminary title reports obtained before January 1, 1982. *White v Western Title Ins. Co.* (1985) 40 C3d 870, 884, 221 CR 509. See also *Herbert A. Crocker & Co. v Transamerica Title Ins. Co.* (1994) 27 CA4th 1722, 1727 n6, 33 CR2d 313; *Southland Title Corp. v Superior Court* (1991) 231 CA3d 530, 538, 282 CR 425. Thus, an insured who received such a report prepared before January 1, 1982, has a potential claim against the insurer for negligence based on the standard of liability applicable to an abstractor. *White v Western Title Ins. Co., supra*; *Herbert A. Crocker & Co. v Transamerica Title Ins. Co.*, *supra*; *Southland Title Corp. v Superior Court*, *supra* (dicta); *Lawrence v Chicago Title Ins. Co.* (1987) 192 CA3d 70, 77, 237 CR 264; *Glavinich v Commonwealth Land Title Ins. Co.* (1984) 163 CA3d 263, 272, 209 CR 266.

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§11.44 2. No Claim on Reports Issued After January 1, 1982

A preliminary report that was issued on or after January 1, 1982, cannot be considered an abstract and constitutes neither a representation on the title of the property nor a representation that a contingency insured against will not occur, and no action for negligence or negligent misrepresentation can be stated against the insurer based on the preliminary report or title policy. *Vournas v Fidelity Nat'l Title Ins. Co.* (1999) 73 CA4th 668, 675, 86 CR2d 490; *Golden Sec. Thrift & Loan Ass'n v First Am. Title Ins. Co.* (1997) 53 CA4th 250, 258, 61 CR2d 442. Any title search or examination made by the insurer is solely for the purpose of evaluating its underwriting decision, not for the benefit of the insured or related third parties. *Siegel v Fidelity Nat'l Title Ins. Co.* (1996) 46 CA4th 1181, 1192, 54 CR2d 84; *Southland Title Corp. v Superior Court* (1991) 231 CA3d 530, 537, 282 CR 425; *Fidelity Nat'l Title Ins. Co. v Miller* (1989) 215 CA3d 1163, 1175, 264 CR 17. See also *Lewis v Superior Court* (1994) 30 CA4th 1850, 1870, 37 CR2d 63. See §13.4.

NOTE: The conclusion reached in decisional law that an insurer's title search made in connection with preparing a preliminary report is solely for the benefit of the insurer is consistent with the language of Ins C §12340.11, which states that the report is an offer to provide a title policy on the terms and conditions stated in that policy. If, as *Southland Title Corp. v Superior Court, supra*, holds, an insurer ignores or omits a recorded matter that is a possible exception to coverage as described in the preliminary report (see §11.42), and the matter was a defect or a lien covered by the subsequently issued policy but not falling within any exception or exclusion to the policy, it is the author's opinion that the matter would be covered. This conclusion is implicit in *Southland*. However, if a recorded item is omitted as an exception or an exclusion from the report but is listed as a typewritten exception in the policy, the insured could seek to have the policy reformed to comply with the report under general contract formation theories.

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Source: Real Property/California Title Insurance Practice/11 Theories and Defenses in Title Company Actions/§11.45 C. Unfair Business Practices

§11.45 C. Unfair Business Practices

The Unfair Competition Law (UCL) (Bus & P C §§17200-17210) has been held to apply to insurance companies providing homeowners' policies, automobile policies, and life insurance policies. The UCL provides equitable relief for unlawful, unfair, or fraudulent business practices, including nonstatutory theories such as fraud and breach of the covenant of good faith and fair dealing. *State Farm Fire & Cas. Co. v Superior Court (Allegro)* (1996) 45 CA4th 1093, 53 CR2d 229 (homeowners' insurer); *Progressive West Ins. Co. v Superior Court* (2005) 135 CA4th 263, 283, 37 CR3d 434 (auto insurer); *Massachusetts Mut. Life Ins. Co. v Superior Court (Karges)* (2002) 97 CA4th 1282, 119 CR2d 190 (life insurer). See also, Ins C §1861.03. Notably, relief under the UCL does not require individualized proof of deception, reliance, or injury. *Fletcher v Security Pac. Nat'l. Bank* (1979) 23 C3d 442, 452, 153 CR 28; *Bank of the West v Superior Court* (1992) 2 C4th 1254, 1266, 10 CR2d 538; *Massachusetts Mut. Life Ins. Co. v Superior Court (Karges)* (2002) 97 CA4th 1282, 1288, 119 CR2d 190. Remedies include injunctive relief, civil penalties, and restitution of property or money obtained as a result of the alleged unfair business practice. Bus & P C §§17203, 17206.

The UCL was held applicable to title insurers in *Quelimane Co. v Stewart Title Guar. Co.* (1998) 19 C4th 26, 77 CR2d 709, in which several title insurers were sued because none of them would issue a title policy on the pending sale of real property that had been the subject of a tax sale more than a year before the pending sale. The California Supreme Court held that although no insurer had a duty to offer a particular class of insurance or to insure particular risks, the allegations of a concerted action in restraint of trade sufficiently alleged a violation of the Cartwright Act (Bus & P C §§16700-16770). The court further held that allegations of violation of the Cartwright Act may form the basis for a civil action under the UCL, and that Ins C §12401 (stating a legislative intent to encourage competition between title insurers), Ins C §12414.26 (pertaining to rate regulation), and Ins C §12414.29 (pertaining to advisory organizations that supply data related to ratemaking) did not preclude the cause of action. 19 C4th at 44.

Compensatory damages or attorney fees are not available to private litigants under the UCL. *Korea Supply Co. v Lockheed Martin Corp.* (2003) 29 C4th 1134, 1144, 131 CR2d 29; *Cortez v Purolator Air Filtration Prods. Co.* (2000) 23 C4th 163, 173, 96 CR2d 518; *Cel-Tech Communications, Inc. v Los Angeles Cellular Tel. Co.* (1999) 20 C4th 163, 187, 83 CR2d 548. Moreover, a court cannot order disgorgement into a fluid recovery fund—*i.e.,* any residue remaining after payment of individual claims—under the UCL. See *Kraus v Trinity Mgmt. Servs.* (2000) 23 C4th 116, 124, 96 CR2d 485 (fluid recovery fund, consisting of defendants' illegal profits, "organized and administered for the purpose of providing financial assistance for the advancement of legal rights and interests of residential tenants in the City and County of San Francisco," is unavailable under UCL). Restitution is limited to profits or money in which the individual has a vested or unconditional interest. *Korea Supply Co.,* 29 C4th at 1149; *Pegasus Satellite Television, Inc. v DirecTV, Inc.* (2004) 318 F Supp2d 968, 979.

Including a UCL cause of action has been increasingly common for insureds suing for bad faith. The UCL will not support a private right of action against an insurer based solely on a violation of the Unfair Insurance Practices Act (UIPA) (Ins C §§790-790.15). *Manufacturers Life Ins. Co. v Superior Court (Weil Ins. Agency)* (1995) 10 C4th 257, 283, 41 CR2d 220. In *State Farm Fire & Cas. Co. v Superior Court, supra (Allegro),* however, the appellate court held that although an insured cannot base a UCL claim on violations of the UIPA, an insured can base a UCL claim on allegations of common law fraud and bad faith. The court held that common law claims for fraud and bad faith "remain as a firm legal basis on which an insured may rely to seek redress against an insurer [under the UCL]." However, in *Textron Fin. Corp. v National Union Fire Ins. Co.* (2004) 118 CA4th 1061, 1070, 13 CR3d 586, a different appellate court found that an insurer's use of misleading documents and misrepresentation of both the terms of the insurance policies and the insurer's obligations under them "are the type of activities covered by the UIPA," and thus could not form the basis for a UCL claim. In *Hangarter v Provident Life & Acc. Ins. Co.* (9th Cir 2004) 373 F3d 998, the Ninth Circuit held an insured who no longer had a contractual relationship with the insurer and could not demonstrate a "real or immediate threat of an irreparable injury" did not have standing to pursue a federal action for injunctive relief under the UCL, even if the insured would have been able to pursue the claim in state court. 373 F3d at 1021. See also California Liability Insurance Practice: Claims & Litigation §28.29 (Cal CEB 1991); California Real Property Sales

Transactions §13.122 (4th ed Cal CEB 2007).

NOTE: In *Cel-Tech Communications, Inc. v Los Angeles Cellular Tel. Co.* (1999) 20 C4th 163, 179, 83 CR2d 548, the supreme court disapproved as overbroad the definition of "unfair" used in *State Farm*, but the court did not disapprove of its holding that common law fraud and bad faith can support a UCL claim. Nevertheless, the *State Farm* case and the *Textron* case do not appear to be reconcilable. The supreme court will ultimately have to decide this issue.

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§11.46 D. Accommodation Recordings

An accommodation recording is an act of courtesy provided by an escrow agent on behalf of one or more parties to the escrow. It involves the delivery of a document (not prepared by the escrow agent) to a county recorder's office for recording to complete a transaction for one or more parties to the escrow. The transaction may be extraneous or collateral to the particular escrow. An accommodation recording may also occur when a title company or an escrow agent records a document (prepared by someone other than the title company or escrow agent) for a customer when there is no pending escrow.

EXAMPLE: In *Seeley v Seymour* (1987) 190 CA3d 844, 237 CR 282, Seeley owned property and negotiated a long-term lease with Seymour, who unilaterally prepared a "Memorandum of Agreement," which set forth the essential terms of the lease. The Memorandum was signed by Seymour, but was never signed or even read by Seeley. Seymour, a regular customer of Safeco Title Company, took the Memorandum to Safeco, which delivered the document, along with other documents insured by Safeco, to the county recorder, who accepted and recorded the Memorandum.

Recording a document as an accommodation may result in liability to the entity responsible for the recording, irrespective of who prepared the document and even if the document is per se legally ineffective. In *Seeley*, for example, the relationship between the parties collapsed and Seeley sued both Seymour and Safeco for damages and to quiet title. It was unclear from the verdict whether the jury's award in favor of Seeley and against the defendants was based on slander of title or negligence, particularly as to defendant Safeco. The appellate court stated, however, that the general verdict in Seeley's favor could be supported on either theory. 190 CA3d at 860.

The court concluded that the gravamen of a cause of action for slander of title is "the reasonably foreseeable effect upon prospective purchasers or lessees, not the strictly legal effect on title of a recorded instrument." 190 CA3d at 859. Therefore, the unilateral nature of the Memorandum, which was insufficient to create lease rights in Seymour, did not preclude a claim for slander of title against Safeco. In response to Safeco's argument that it could not be held liable to Seeley for negligently recording the document as an "accommodation" to Seymour, the court held that Safeco owed a duty to Seeley based on four factors, including the element of foreseeability that Seeley would suffer economic harm as a result of the recording. 190 CA3d at 861.

A title company may protect itself by requiring the party who requests the accommodation recording to execute an agreement to indemnify the company from liability arising from the recording transaction. See *Rooz v Kimmel* (1997) 55 CA4th 573, 64 CR2d 177.

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Source: Real Property/California Title Insurance Practice/11 Theories and Defenses in Title Company Actions/§11.47 E. Escrow Liability

§11.47 E. Escrow Liability

A title insurer that also acts as an escrow holder will be held responsible for any negligence in carrying out its duties as the escrow holder. *Summit Fin. Holdings, Ltd. v Continental Lawyers Title Co.* (2002) 27 C4th 705, 711, 117 CR2d 541 (stating rule, but finding no breach); *Amen v Merced County Title Co.* (1962) 58 C2d 528, 532, 25 CR 65 (failure to follow written escrow instruction); *Zang v Northwestern Title Co.* (1982) 135 CA3d 159, 166, 185 CR 176 (failure to follow oral escrow instruction).

Title insurers acting as escrow agents who do not comply with escrow instructions may be sued for breach of contract independently of the insurance policy. *Summit Fin. Holdings, Ltd. v Continental Lawyers Title Co., supra* (stating rule, but finding no breach); *Amen v Merced County Title Co., supra*; *Markowitz v Fidelity Nat'l Title Co.* (2006) 142 CA4th 508, 526, 48 CR3d 217 (stating rule, but finding no breach). See also *Bear Creek Planning Comm. v Title Ins. & Trust Co.* (1985) 164 CA3d 1227, 1239, 211 CR 172, disapproved on other grounds in *Bay Dev., Ltd. v Superior Court* (1990) 50 C3d 1012, 1032 n12, 269 CR 720, a slander of title action in which a title company (acting as agent for escrow) was held totally liable to a homeowners' association on a cross-complaint for implied contractual indemnity for failure to follow instructions to officially record CC&Rs. This failure had caused a lack of constructive notice of the CC&Rs to a subsequent buyer of the lot, who refused to abide by the restrictions in the CC&Rs. The buyer successfully sued the association for slander of title after the association had recorded a notice of violation of the CC&Rs. The *Bear Creek* case is also noteworthy because the title company argued for an apportionment of liability based on a theory of comparative equitable indemnity because the association was found liable for slander of title, but the court rejected that theory, finding no joint tortfeasor relationship between the title company and the association. 164 CA3d at 1238.

An escrow agent may also be liable to an assignee of sales proceeds for failing to follow an instruction by a party to the escrow to remit the proceeds to the assignee on close of escrow. *Builders' Control Serv. v North Am. Title Guar. Co.* (1962) 205 CA2d 68, 73, 22 CR 712. Exculpatory language in escrow instructions that attempts to limit the agent's liability may be unenforceable as against public policy. *Akin v Business Title Corp.* (1968) 264 CA2d 153, 158, 70 CR 287.

The liability of a title insurer and that of an escrow agent are separate and distinct. *Contini v Western Title Ins. Co.* (1974) 40 CA3d 536, 547, 115 CR 257. A title company participating in a transaction in both capacities, however, may find lawsuits against it difficult to defend when multiple theories are alleged. See §11.48. An escrow agent's duties are more fiduciary in nature, but are limited by the escrow instructions. For example, unless instructed otherwise, an escrow agent is entitled to rely on a payoff demand by a beneficiary as the amount needed to satisfy the obligation and reconvey the deed of trust, even when the agent has information that the amount demanded is insufficient to pay the loan in full. *Cathay Bank v Fidelity Nat'l Title Ins. Co.* (1996) 46 CA4th 266, 53 CR2d 595. An escrow agent does have a fiduciary duty, however, to inform a party to the escrow of material facts that might affect a party's decision on a pending transaction, particularly when the party is relying on the superior knowledge of the agent. *Kirby v Palos Verdes Escrow Co.* (1986) 183 CA3d 57, 65, 227 CR 785, disapproved on other grounds in *Summit Fin. Holdings, Ltd. v Continental Lawyers Title Co.* (2002) 27 C4th 705, 714, 117 CR2d 541. See also *Axley v Transamerica Title Ins. Co.* (1978) 88 CA3d 1, 9, 151 CR 570.

As a dual agent of the parties to the escrow, the escrow agent owes certain duties to all parties to the escrow. *Vournas v Fidelity Nat'l Title Ins. Co.* (1999) 73 CA4th 668, 674, 86 CR2d 490. The escrow agent's primary duty is to strictly and faithfully perform the instructions given to it by the parties. When the agent knows that a party is relying on him or her for protection as to facts learned by the escrow agent, the agent can be liable to that party by not disclosing those facts. 73 CA4th at 674; *Markowitz v Fidelity Nat'l Title Co.* (2006) 142 CA4th 508, 528, 48 CR3d 217. If the party is already aware of the undisclosed fact, however, there is no basis to impose liability on the agent. *Vournas,* 73 CA4th at 674.

However, a nonparty to the escrow cannot base a claim on alleged failure to follow the escrow instructions. *Markowitz,* 142 CA4th at 527. In *Summit Fin. Holdings, Ltd. v Continental Lawyers Title Co.* (2002) 27 C4th 705, 117 CR2d 541, the maker of a promissory note secured by a deed of trust on real property refinanced the secured

obligations by obtaining a new loan from a new lender. A title company provided escrow services for the refinance transaction and was instructed by the parties to the escrow to pay the note to the original lender. The title company followed that instruction. The original lender had assigned its rights under the note and deed of trust. The assignee later sued the title company for breach of fiduciary duty and negligence. The assignee alleged that, in the refinance transaction, the title company should have paid the assignee, not the assignor. The supreme court held that the assignee had no viable cause of action for breach of fiduciary duty or negligence because the title company owed no duty to the assignee, as it was a stranger to the escrow. 27 C4th at 707. The court noted the escrow company's obligations were "limited to faithful compliance with [the depositors'] instructions." 27 C4th at 711. The notice of an assignment did not constitute an amendment to the escrow instructions. The court disapproved *Kirby v Palos Verdes Escrow Co.* (1986) 183 CA3d 57, 227 CR 785 to the extent it is contrary to that holding.

An insured cannot impose abstractor liability on a title insurance company without an express agreement. Under Ins C §12340.11, an abstract of title may be requested orally. Few California title companies now perform an abstract, however, even if requested, because this service has been phased out. See also §5.25.

PRACTICE TIP: An insurer who also acts as the escrow agent should take precautions to make sure that it does not assume greater obligations. Insurers should instruct their escrow personnel never to make any statements to the effect that the preliminary report shows all matters of record. If such personnel advise the insured that the preliminary report shows all matters of public record, the insured may argue that the insurer assumed liability as an abstractor. The insurer will respond by arguing that the insured could not reasonably rely on such a statement, because the standard preliminary report states on its face that no representation is made as to the true state of title. However, to minimize the potential for such disputes, the insurer may issue a written directive to its escrow personnel that they cannot make such a statement, and that, if the insured asks whether the preliminary report shows all matters of record, the escrow agent should clearly explain the difference between a preliminary report and title policy versus an abstract. The insurer may also consider directing escrow personnel to explain these differences in every case, by adding a "check-the-box" section to escrow instructions for the insured to initial, acknowledging that these differences have been explained.

Escrow liability defenses are discussed in §11.121. Additional theories of liability of insurers acting as escrow agents are given in §11.46 (accommodation recordings) and §11.49 (slander of title). A title insurer's duties when acting as an escrow agent are discussed in part in §§10.2-10.5. On escrow agent's duties and liability generally, see California Real Property Sales Transactions, chap 15 (4th ed Cal CEB 2007).

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Source: Real Property/California Title Insurance Practice/11 Theories and Defenses in Title Company Actions/§11.48 F. Fraud

§11.48 F. Fraud

Under appropriate facts, a title insurer may be held liable for fraud. For example, in *Moe v Transamerica Title Ins. Co.* (1971) 21 CA3d 289, 305, 98 CR 547, a title company, having actual knowledge of a bankruptcy proceeding and certain liens against property, issued a title policy that omitted any reference to the bankruptcy proceeding or liens. An officer at the title company (also the escrow agent) conspired with others to defraud the insureds and induced them to purchase a worthless security interest. In addition, when the insureds asked why they were assigned an existing title policy rather than issued a new one, the insurer's employee assured them that the policy afforded as complete protection as a new policy. The court affirmed a jury verdict based on fraud, among other things. Noting that the title company, as the escrow agent, had a fiduciary obligation to the plaintiffs, the court stated that fraud may be based on intentional failure to disclose a material fact when the fiduciary relationship gives rise to a duty to disclose it. 21 CA3d at 306. The opinion does not state whether the fraud verdict was upheld against the company in its capacity as an insurer or as an escrow agent.

In *Alliance Mortgage Co. v Rothwell* (1995) 10 C4th 1226, 44 CR2d 352, Alliance alleged that it was induced by fraud to make loans for the purchase of nine properties. Among the participants was the title insurer. Alliance alleged that the defendants created fictitious buyers, as well as fictitious employers, to "verify" the income and employment of the buyers, and that they falsified purchase agreements, loan applications, appraisals, and comparable sales information. The insurer issued title policies falsely describing some of the single-family residences as four-unit dwellings. When the fictitious buyers defaulted on the loans, Alliance purchased the properties at trustee sales through full credit bids. Alliance alleged that the misrepresentations also caused it to make the full credit bids. The trial court had dismissed all causes of action against the title company defendants on the ground that the full credit bids barred claims for damages resulting from misrepresentations of the value of the security.

The court of appeal reversed, concluding that, although a title policy is not a guarantee of title, Alliance had stated a fraud cause of action against the title insurer because Alliance was not claiming that it relied on any representation of the condition of title to the properties but on a misrepresentation of the nature and description of the properties securing the loans. 10 C4th at 1234. The supreme court affirmed and held that the full credit bid rule did not bar the lender's fraud claim against nonborrower third parties. The court held that, although the lender usually bears the burden and the risk of making an informed bid, the risk did not include being intentionally misled by fiduciaries or agents. The court ruled that, to establish reliance, Alliance need only prove that in the absence of the fraud "it would not, in all reasonable probability, have made the bids." 10 C4th at 1246. The court further held that to the extent the bids were caused by the fraud, and Alliance's reliance on the misrepresentations without independent inquiry was either appropriate given the relationship between the parties or was otherwise not manifestly unreasonable, the bids could not be deemed an admission by Alliance as to the value of the properties, *i.e.,* the full credit bid rule does not apply. However, if the bids were not caused by the fraud or if Alliance's reliance without further inquiry was either inappropriate or was otherwise manifestly unreasonable, the full credit bid rule would apply to preclude Alliance from recovering the difference between the bids and the value of the properties, but would not preclude Alliance from recovery of other damages caused by the fraud. 10 C4th at 1247.

The court in *Alliance* did not reach the issue of whether the defendant title companies were acting as fiduciaries. 10 C4th at 1246 n8. It has been held that a title insurance company is not a fiduciary when acting solely in its capacity as an insurer. See *Rice v Taylor* (1934) 220 C 629, 635, 32 P2d 381; *Lewis v Superior Court* (1994) 30 CA4th 1850, 1869, 37 CR2d 63. Compare *Rice* and *Lewis* with cases discussed in §11.47. The supreme court limited the rule in *Alliance* to fraud claims. 10 C4th at 1241. In *Pacific Inland Bank v Ainsworth* (1995) 41 CA4th 277, 282, 48 CR2d 489, the court held that a lender's full credit bid barred an action against an appraiser who was negligent in preparing a report for use by the lender in making a development loan. For further discussion of *Alliance* and *Pacific Inland Bank*, see 18 CEB Real Prop L Rep 319, 323 (Nov. 1995) and 19 CEB Real Prop L Rep 73 (Mar. 1996), respectively.

Absent fraud extrinsic to the title policy found in both *Alliance* and *Moe*, in which the insuring company also was the escrow agent, or absent misrepresentations related to issues other than condition of title as in *Alliance*, it seems

doubtful that an insured could easily allege fraud against a title insurer, particularly in light of Ins C §12340.11 (preliminary reports are not representations of the condition of title) and cases such as *Southland Title Corp. v Superior Court* (1991) 231 CA3d 530, 537, 282 CR 425 (reliance on preliminary report for status of title deemed unreasonable).

For example, in *Golden Sec. Thrift & Loan Ass'n v First Am. Title Ins. Co.* (1997) 53 CA4th 250, 253, 61 CR2d 442, the title policy included an endorsement insuring that the dimensions of the property as shown on the map attached to the policy were correct. See CLTA endorsement in §§8.93-8.94. The map correctly depicted the length of each boundary line, but incorrectly listed the area of the property as 2.06 acres "more or less." In fact, the property contained only about 1.36 acres. When the owner defaulted on the loan, the insured lender foreclosed, purchased the property, and put it up for sale. The lender anticipated it would suffer a substantial loss upon sale due to the shortage in area. The lender therefore gave the title insurer notice of a claim under the policy. After the insurer denied the claim, the insured filed suit alleging, inter alia, negligent misrepresentation.

The trial court granted summary judgment in favor of the insurer. The appellate court affirmed, explaining that the title policy itself is not a representation that the insured contingency will not occur and that the insured had not shown the insurer made any representations outside the policy itself. 53 CA4th at 258. For additional discussion of the *Golden Sec.* case, see §11.65A.

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§11.49 G. Slander of Title

Slander of title is the unprivileged publication of false information about real property that adversely affects its marketability, resulting in monetary loss to the holder of the affected interest. *Gudger v Manton* (1943) 21 C2d 537, 134 P2d 217, disapproved on other grounds in *Albertson v Raboff* (1956) 46 C2d 375, 381, 295 P2d 405; *Stalberg v Western Title Ins. Co.* (1994) 27 CA4th 925, 929, 32 CR2d 750. The essential elements of a cause of action for slander of title are (1) disparagement of the interest, (2) publication, (3) falsity of the information published, (4) lack of privilege, and (5) monetary damages. *Gudger v Manton, supra*. See also *Truck Ins. Exch. v Bennett* (1997) 53 CA4th 75, 84, 61 CR2d 497.

The thrust of the tort is to protect the marketability of property. *Howard v Schaniel* (1980) 113 CA3d 256, 264, 169 CR 678. The key to whether the publication is actionable is whether the defendant could reasonably foresee that the conduct of a third party purchaser or lessee might be affected, which is an issue of fact. *Seeley v Seymour* (1987) 190 CA3d 844, 858, 237 CR 282. When a defendant's conduct is justified by the application of an absolute privilege, the cause of action is defeated. *Albertson v Raboff* (1956) 46 C2d 375, 295 P2d 405; *Wilton v Mountain Wood Homeowners Ass'n* (1993) 18 CA4th 565, 569 n1, 22 CR2d 471 (recording lis pendens in action affecting title or possession to property in court of competent jurisdiction is absolutely privileged under CC §47(b)(4)).

When a defendant's conduct is conditionally privileged, however, proof of malice is required to maintain an action for slander of title. *Spencer v Harmon Enters.* (1965) 234 CA2d 614, 622, 44 CR 683. Although the existence of a privileged publication is usually raised by an affirmative defense, when the allegations in a complaint reveal the application of a qualified privilege, the plaintiff must also allege malice to state a cause of action. *Smith v Commonwealth Land Title Ins. Co.* (1986) 177 CA3d 625, 630, 223 CR 339. Recording a document with knowledge that it contains false information is sufficient to support a finding of implied malice. *Contra Costa County Title Co. v Waloff* (1960) 184 CA2d 59, 66, 7 CR 358.

Moreover, the absolute privilege of CC §47(b) does not apply to recording a lis pendens unless the underlying action properly alleges a real property claim, and it is the defendants' burden to demonstrate that they had alleged a real property claim in the underlying action. *Palmer v Zaklama* (2003) 109 CA4th 1367, 1380, 1 CR3d 116. In *Palmer,* the court held that the defendants' appeal of a collection action against them was not an appropriate action for recordation of a lis pendens because it was a slander of title action for money damages. 109 CA4th at 1381.

Recoverable damages include the expense of legal proceedings against third parties necessarily brought to remove the disparagement of title, financial loss resulting from the effect on marketability, and general damages for the plaintiff's time and inconvenience, but not compensation for emotional distress. *Seeley v Seymour* (1987) 190 CA3d 844, 865, 237 CR 282. When the disparagement of title also results in construction delay, the affected owner may recover increased costs of construction and attorney fees. *Appel v Burman* (1984) 159 CA3d 1209, 1215, 206 CR 259. In addition to a civil tort action, slander of title may be actionable as a crime. Pen C §§115, 531a.

Assuming that all elements necessary to state the slander of title action are alleged, the theory is available not only to owners in fee but to other holders of interests in property. See *Smith v Commonwealth Land Title Ins. Co.* (1986) 177 CA3d 625, 223 CR 339 (trust deed holder); *Southcott v Pioneer Title Co.* (1962) 203 CA2d 673, 21 CR 917 (obligee of recorded contract to convey property); *Baker v Kale* (1947) 83 CA2d 89, 189 P2d 57 (lessee).

Defendant parties include title companies and escrow agents. *Stalberg v Western Title Ins. Co.* (1994) 27 CA4th 925, 32 CR2d 750; *Stalberg v Western Title Ins. Co.* (1991) 230 CA3d 1223, 1226, 282 CR 43 (title company as both escrow agent and insurer of both parties to easement recorded fictitious easement on behalf of upstream owners affecting plaintiffs' downstream properties); *Seeley v Seymour* (1987) 190 CA3d 844, 858, 237 CR 282 (accommodation recording by title company of memorandum of lease, which only one party signed).

Slander of title defenses are discussed in §§11.113-11.120. For further discussion of slander of title actions generally, see California Real Property Remedies and Damages, chap 9 (2d ed Cal CEB 2002).

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§11.50 H. Other Tort Claims

Under the appropriate facts, an insurer may be held liable under virtually any tort theory, *e.g.:*

- Fraud (*Mosier v Southern Cal. Physicians Ins. Exch.* (1998) 63 CA4th 1022, 1045, 74 CR2d 550);
- Defamation (*Sanchez v Lindsey Morden Claims Servs.* (1999) 72 CA4th 249, 254, 84 CR2d 799);
- Intentional infliction of emotional distress (*Gruenberg v Aetna Ins. Co.* (1973) 9 C3d 566, 578, 108 CR 480; *Crisci v Security Ins. Co.* (1967) 66 C2d 425, 433, 58 CR 13);
- Invasion of privacy (*Heller v Norcal Mut. Ins. Co.* (1994) 8 C4th 30, 35, 32 CR2d 200 (no cause of action allowed owing to lack of reasonable expectation of privacy in information at issue)); or
- Spoliation of evidence; such a claim may be limited, however, to a claim for negligent spoliation against someone who is not a party to the lawsuit [a "third party spoliator"] only when there was (1) a specific agreement to preserve the evidence; or (2) a specific request to preserve the evidence, accompanied by an offer to pay the cost or bear the burden of preserving it; or (3) a voluntary undertaking to preserve evidence that induces reasonable reliance. *Johnson v United Servs. Auto. Ass'n* (1998) 67 CA4th 626, 635, 79 CR2d 234. Moreover, a tort cause of action for negligent spoliation of evidence committed by a party to the action is not permitted. *Coprich v Superior Court* (2000) 80 CA4th 1081, 1089, 95 CR2d 884. Further, a tort cause of action for intentional spoliation is not permitted against someone who is not a party to the action. *Temple Community Hosp. v Superior Court* (Ramos) (1999) 20 C4th 464, 477, 84 CR2d 852.

For discussion of other tort principles, see California Liability Insurance Practice: Claims & Litigation, chap 28 (Cal CEB 1991).

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V. THIRD PARTY CLAIMS

§11.51 A. Introduction

This portion of the chapter (§§11.51-11.58) addresses title-insurance-based third party claims and generally defines what they are and how they are presented. Most third party claims arise from interests in real property, such as mechanics' liens, judgment liens, deeds of trust, other recorded liens, easements, leaseholds, and other adverse interests. These interests may be insured against by a title policy issued either to a new owner in a transaction that occurs after the third party's interest attaches or to a lender in order to protect the priority of the lender's secured interest.

A third party claimant is not the insured party; rather, it is an adversary to the insured, and its primary rights of action are against the insured. See §11.3. If the third party's adverse interest is insured against, the insurer has a duty under the policy to defend a lawsuit against the insured by the third party and indemnify the insured against an adverse judgment. See §§12.13-12.15, 12.27-12.34. The insurer also has statutory duties to investigate third party claims and settle those that have merit. See §§11.54, 12.24-12.26.

Because the third party is not a party to the insurance contract, it is not bound in the same manner as the insured to comply with the claims procedures in the title policy. If an insurer refuses to settle a third party claim, the remedies available to the third party differ from those available to the insured. The third party claimant's primary right of action, after exhausting the claims process, is against the insured, its property, or both. The insured then tenders its defense and requests indemnity from the insurer. For discussion of the differences between first and third party claimants, see §§1.3, 13.5-13.10.

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§11.52 B. When to Assert Third Party Claims

A claim based on a third party lien should be pursued against the insured property as soon as possible after the claimant discovers that the debt was not paid when the new transaction was consummated. A claim relating to an insured loan's priority over the third party lien should be brought when a default occurs on the underlying obligation and the equity in the security is insufficient to support the secured debts. Other third party claims should be asserted as soon as the claimant discovers that its interest or priority is disputed.

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Source: Real Property/California Title Insurance Practice/11 Theories and Defenses in Title Company Actions/§11.53 C. Threshold Considerations

§11.53 C. Threshold Considerations

The prerequisites to a notice of claim or a demand vary according to the nature of the interest. A third party claimant should generally take the following steps before asserting its claim under a title policy:

- Review the title policy to ascertain whether its interest is insured against;
- If applicable, review the public records to learn whether constructive notice requirements were met; and
- Evaluate the merits of the third party's claim vis-à-vis the policyholder's interest.

The initial preclaim investigative procedure most common to all third party claims involves a thorough review of the policy. If counsel for the claimant can ascertain from the escrow the type of title policy issued, it will specify whether the third party's interest was insured against. Second, before contacting the insurer, it is necessary to learn whether the lien or encumbrance was recorded in a manner that imparts constructive notice. Constructive notice is primarily a requirement for coverage under the CLTA policy. See §§4.7-4.9. Under an ALTA owner's policy, however, constructive notice is seldom an issue because the insured's protection is not limited to matters appearing in the public record. See §§6.8, 6.11, 6.23. Finally, the merits of the third party's claim against the insured's interest should be thoroughly evaluated. This step should be distinguished from any theories that the plaintiff may consider asserting directly against the insurer, which theories are limited by lack of privity with the insurer. See §§11.4, 11.16.

Although the third step, weighing the merits of the claim against the insured's interest, may appear self-evident, its importance should not be overlooked. For example, in *Stagen v Stewart-West Coast Title Co.* (1983) 149 CA3d 114, 117, 196 CR 732, the plaintiff contracted to purchase property owned by a married couple holding title as joint tenants. Only the husband executed the contract. Later, the husband refused to close escrow and plaintiff brought an action for specific performance and recorded a lis pendens. The next day, the husband and wife sold the property to two other people, who purchased a title insurance policy. The preliminary report did not mention the lis pendens. The plaintiff amended the complaint to include the buyers and their title insurer. The insurer prevailed on a motion for judgment on the pleadings, having asserted that the plaintiff was not an intended third party beneficiary of the insurance contract and not within the class of persons intended to benefit from a title report (the preliminary report and title policy were issued in 1976, before passage of Ins C §12340.10). 149 CA3d at 117.

The court of appeal upheld the judgment on the pleadings, holding that the plaintiff could not take direct action against the insurer, because the title insurer owed no duty to the plaintiff either in contract or in tort. 149 CA3d at 119. The court noted that the trial court denied the plaintiff specific performance "because the property was the community property of the seller and his wife, the wife did not execute the sales contract," and the plaintiff was aware of these facts. The court observed that, if the plaintiff had won his action for specific performance, the timing of the recording of the lis pendens would have compelled the buyers to convey the property to the plaintiff. 149 CA3d at 123. See §13.7.

What the *Stagen* opinion did not mention is that, if the plaintiff had prevailed on the remedy of specific performance, the innocent buyers most likely would have been entitled to indemnity from the title insurer because the preliminary report and the policy did not exclude the rights asserted in the lis pendens from coverage, and the insurer (on the insured buyers' request) would have had to defend a cause of action to quiet title against the buyers. *Stagen* illustrates that a third party generally cannot sue the insurer but must pursue the insured or its property. A third party, however, can participate in the claims process.

PRACTICE TIP: When an investigation reveals that the claim against the insured is potentially meritorious and the third party interest is covered by the title policy, counsel for the third party should notify both the title insurer and the insured. It is not uncommon for an insurer to receive a claim report or a notice of claim from a source other than its own insured. One possible form is a demand letter to the insured with a copy to the title insurer, requesting the insured to tender the claim to the insurer. If the claim does not require immediate legal action, it is usually more economical to exhaust all prelitigation claims processes with the title insurer and the insured before bringing an action. If the claimant can successfully demonstrate to the insurer that its interest is insured against by the policy and that its claim is valid, a settlement of the claim without litigation against the insured may result.

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§11.54 D. Insurer's Duties

Although insurers are generally not contractually bound to third party claimants (*Murphy v Allstate Ins. Co.* (1976) 17 C3d 937, 944, 132 CR 424; *Stagen v Stewart-West Coast Title Co.* (1983) 149 CA3d 114, 119, 196 CR 732), insurers do have statutory and regulatory duties to investigate and resolve third party claims promptly and fairly. See Unfair Practices Act (Ins C §790.03(h)), Fair Claims Settlement Practice Regulations (10 Cal Code Regs §§2695.1-2695.14) and the authorities discussed in §§12.19, 12.24-12.25, 12.35-12.38 and in California Liability Insurance Practice: Claims & Litigation, chaps 9, 14, 28 (Cal CEB 1991).

NOTE: If a third party claim is not covered by the title policy, or if the insurer does not settle an otherwise meritorious claim, the third party's alternative is to sue the insured, who will then defend the action or tender the defense to the insurer. Although third party claimants have no contractual rights arising from either the policy (see §11.4) or the implied covenant of good faith and fair dealing (see §11.16), they may sue an insurer for breach of contract or bad faith when an insured assigns those rights to them (see §11.4).

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E. Categories of Third Party Claims

§11.55 1. Mechanics' Liens

The CLTA policy and the ALTA owner's policies do not normally cover mechanics' liens, recorded or otherwise, especially when the owner initiated the improvement. See §§6.30, 6.41-6.42, 7.14. However, a special CLTA endorsement is available to a new owner who acquires the property before expiration of the lien period if certain conditions are met. See §§7.88-7.89. The ALTA lender's policies contains broad protection against mechanics' liens, and a variety of special endorsements are available, depending on the nature and circumstances of the loan. See §§6.30, 6.47, 8.34-8.37, 8.83-8.84. See also §11.102.

The viability of a mechanics' lien depends on compliance with the statutory requirements to perfect the lien. See, *e.g.,* CC §§3097, 3115-3116, 3144. For a comprehensive discussion of the enforcement of mechanics' liens, see California Mechanics' Liens and Related Construction Remedies, chaps 2-3 (3d ed Cal CEB 1998) (foreclosure processes for private works); Mechanics' Liens, chap 4 (foreclosure processes for public works); and Handling Mechanics' Liens and Related Remedies (Private Works) (Cal CEB Action Guide October 2008).

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§11.56 2. Judgment Liens

Unlike mechanics' liens, the enforcement of judgment liens (once they are recorded as "abstracts of judgment") does not require rigorous compliance with a statutory schedule to perfect the lien. The lien is perfected on its recording. See CCP §§697.310, 697.340. If the title insurer does not accept liability, a writ of execution for a forced sale of the property is the primary collection alternative for the lienholder. See CCP §§700.015, 701.510-701.680. See also §6.23 for discussion of insuring language for judgment liens. For further discussion, see §11.63 (defenses); Debt Collection Practice in California, chaps 9-10 (2d ed Cal CEB 1999).

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§11.57 3. Deeds of Trust

A lender holding a deed of trust may either be a first party claimant or a third party claimant against a title insurance policy, depending on when and to whom the policy was issued. First party claims arise from the type of policy issued to a lender at the time the loan is made, such as the ALTA lender's policy (discussed in chap 8). Claims made by a named insured under a lender's policy are discussed in §§8.41-8.46, 11.10-11.14.

However, a beneficiary of a deed of trust who remains unpaid after title to the property becomes insured in a subsequent transaction may have a third party claim for the unpaid balance of the underlying loan, if there is a default on the loan and if the deed of trust is not among the exclusions or exceptions. If the title insurer does not accept liability, the beneficiary may foreclose by either a lawsuit or a trustee's sale. See §6.23. See also California Mortgages, Deeds of Trust, and Foreclosure Litigation, chaps 2-3 (4th ed Cal CEB 2009).

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§11.58 4. Other Encumbrances

Other third party claims arise from encumbrances such as easements, leasehold interests, covenants running with the land, boundary disputes, and obligations arising from CC&Rs. See §6.23. Generally, if the title insurer refuses to acknowledge liability and resolve the conflict between the third party claimant and the insured owner or lender, the claimant must pursue against the insured a quiet title action, an action for injunctive relief or specific performance, or other appropriate measures, which may include an action for damages. For further discussion of available options, see California Real Property Remedies and Damages, chap 5 (2d ed Cal CEB 2002) (actions for specific performance), Real Property Remedies, chap 7 (quiet title actions).

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§11.59 VI. TITLE INSURER'S DEFENSES: INTRODUCTION

An action brought against a title insurer might include theories based on breach of the insurance contract, breach of the implied covenant of good faith and fair dealing, fraud, intentional infliction of emotional distress, invasion of privacy, or intentional or negligent spoliation of evidence. If malice, fraud, or oppression are alleged, the claim may include a request for punitive damages.

The defenses available to the title insurer depend on the facts of the case and on the cause of action pleaded. A typical bad faith claim involves three levels of proof by the insured: (1) the insurer breached the insurance contract or otherwise impaired the insured's rights to receive its benefits (see §11.16); (2) the insurer acted in bad faith (see §§11.18-11.29); and (3) there is evidence of the insurer's malice, oppression, or fraud to support a punitive damages claim (see §§11.35-11.37). Any alternative tort theories that are pleaded will require an additional layer of proof that the insurer engaged in the alleged tortious conduct (see §§11.38-11.50).

Because claims of bad faith and punitive damages usually cannot stand without proof that the insurer breached the contract, the insurer's first line of defense is usually that the policy does not cover the claim (*Manneck v Lawyers Title Ins. Corp.* (1994) 28 CA4th 1294, 1304, 33 CR2d 771) or, in the event of a failure to defend, that the claim was not potentially covered by the policy (*Waller v Truck Ins. Exch.* (1995) 11 C4th 1, 26, 44 CR2d 370). See also *Rosen v Nations Title Ins. Co.* (1997) 56 CA4th 1489, 1502, 66 CR2d 714. Even if the insurer breached the contract, the second line of defense will be that the insurer did not act in bad faith. The third line of defense will be that, even if the insurer did breach the contract and act in bad faith, its conduct did not rise to the level of malice, fraud, or oppression sufficient to justify a punitive damages award. If alternative tort theories are pleaded, the insurer must raise another line of defense to establish that it did not engage in the tortious conduct alleged.

Because proof that the claim was not covered or not potentially covered usually eliminates bad faith and punitive damage claims, as well as breach of contract claims, the following sections address defenses that establish lack of actual or potential coverage under the insurance policy (see §§11.60-11.102), defenses that negate a showing of bad faith (see §§11.103-11.106), defenses to malice, fraud, or oppression (see §§11.107-11.111), and defenses to selected alternative tort theories (see §§11.112-11.122).

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VII. POLICY-RELATED DEFENSES

§11.60 A. Defenses to Coverage or Potential Coverage

The insurer's defenses to coverage may involve the insuring language itself (see §§6.20-6.33), or exceptions or exclusions in the policy, many of which are discussed in §§6.34-6.57, 7.16-7.27, 7.42-7.44. A defense to coverage may be based on the insured's failure to provide timely notice of the claim or timely or sufficient proof of the loss. And, although technically not a defense, the insurer may seek to terminate its liability by tendering policy limits. If the claim was filed too late, the statute of limitations may bar the claim. If the insured concealed or misrepresented material facts or breached a material warranty, the insurer may seek to rescind the policy or use the insured's conduct as a basis to preclude coverage.

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1. Defenses Based on Insuring Language

§11.61 a. Title Vested Other Than as Stated in Policy

The first provision of the CLTA policy, the 1992 ALTA owner's and lender's policies, and the 2006 ALTA owner's and lender's policies protects the insured if title is vested other than as stated in the policy. For example, in *Hall v San Jose Abstract & Title Ins. Co.* (1959) 172 CA2d 421, 428, 342 P2d 362, a judgment for the insured against the insurer was affirmed when the policy had misdescribed the title as being vested in the husband and wife as joint tenants, whereas title was actually vested in the husband and wife as tenants-in-common. If the title is vested as stated in the policy, the insured must establish some other insured defect in the title. See §6.22. See also §7.23.

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Source: Real Property/California Title Insurance Practice/11 Theories and Defenses in Title Company Actions/§11.62 b. 'Marketable Title' Versus 'Market Value'

§11.62 b. "Marketable Title" Versus "Market Value"

The second provision of the CLTA policy, the 1992 ALTA owner's and lender's policies, and the 2006 ALTA owner's and lender's policies protects the insured against any "defect in" the title. A third protects the insured against unmarketability of the title. A distinction must be drawn between defective or unmarketable title versus property that is unmarketable because of lack of value. See §§6.24-6.26.

In *Mortgage Assocs., Inc. v Fidelity & Deposit Co.* (2002) 105 CA4th 28, 129 CR2d 365, a mortgage lender's employees engaged in fraud with third parties to arrange loans in excess of the value of the mortgaged properties. The lender was able to foreclose on the properties and obtain title, but sustained losses on each property. The lender made a claim under its title policy, which denied coverage. The appellate court affirmed summary judgment in favor of the insurer in the lender's breach of contract and bad faith action. The court held that the losses were not caused by any past or present defect in title, explaining that "[i]mpaired value is not the same as a defect in title." 105 CA4th at 37.

In *Elysian Inv. Group v Stewart Title Guar. Co.* (2002) 105 CA4th 315, 129 CR2d 372, the insured purchased a residence with a garage that had been converted into a second dwelling unit without the required permit. After the purchase, the insured discovered that a notice had been recorded that classified the premises as substandard. Under the notice, the city had the right to contract out work to correct any deficiency, charge the insured, and assess a lien on the property. The title insurance policy did not list the notice as an exception to coverage. The title company denied the insured's claim, and the insured sued for breach of contract and bad faith. The court of appeal affirmed summary judgment in the title insurer's favor, holding that the notice did not affect title. The appellate court noted that title insurance is a contract to indemnify against loss or encumbrances that may affect title at the time when the policy is issued, but does not afford coverage for physical conditions of the property that merely affect value. 105 CA4th at 320. The court further noted that the fact that the insured may have incurred unexpected expenses or may be required to bring the property up to code did not cast doubt on who owns the property. 105 CA4th at 324.

In *Hocking v Title Ins. & Trust Co.* (1951) 37 C2d 644, 651, 234 P2d 625, the insured purchased unimproved property and received a grant deed, which described the property according to a recorded subdivision map as two lots. However, because the subdivider had not complied with various local ordinances, the city would not issue building permits until the insured complied. The insured sought damages under the title policy, claiming defective title. The *Hocking* court found no title defect and noted the distinction between the physical condition of the land and its title, observing that an owner may have perfect title to land that is unmarketable because of its physical condition.

Thus, the *Hocking* court held that the owner's inability to make economic use of the land based on the subdivider's violations of law did not render the title defective or unmarketable under the terms of the title policy, and it remarked that remedies against parties other than the insurer were appropriate for misrepresentations made regarding the condition and value of the land. 37 C2d at 652.

In *Lick Mill Creek Apartments v Chicago Title Ins. Co.* (1991) 231 CA3d 1654, 1660, 283 CR 231, the court distinguished between market value and marketability of the land, on the one hand, and marketability of the title, on the other. In *Lick Mill*, the prior property owner had been ordered to clean up hazardous substances on the property, but failed to do so. He then conveyed the property to the insureds, who purchased title insurance from Chicago Title. After incurring clean-up costs on the property, the insureds sought indemnity under their title policy. Relying on *Hocking v Title Ins. & Trust Co.* (1951) 37 C2d 644, 234 P2d 625, the *Lick Mill* court concluded (231 CA3d at 1662):

> We find no ambiguity in the insuring clause: defendants are obligated to insure plaintiffs against unmarketability of title on the subject property. Because marketability of title and the market value of the land itself are separate and distinct, plaintiffs cannot claim coverage for the property's physical condition under this clause of the insurance policies.

Similarly, in *Coleman v Security Title Ins. Co.* (1963) 218 CA2d 444, 445, 32 CR 575, insureds purchased vacant land that the title policy erroneously described as being located in an irrigation district. The trial court held that including words in the policy indicating that the property was in the irrigation district did not violate the covenant in the policy against unmarketability and that the plaintiffs had obtained the exact title that they had purchased. Notably, nothing in

the deed to the property indicated that the land was in the irrigation district, and no other representations had been made to the insureds that the land was in the district. The court therefore concluded that the insureds should not succeed in attempting to obtain a "windfall" from the insurer.

In *Mellinger v Ticor Title Ins. Co.* (2001) 93 CA4th 691, 113 CR2d 357, the plaintiffs purchased property intending to obtain approval for subdivision for residential development and to re-sell the property to a developer. After the purchase, the plaintiffs learned that a busy city street encroached on the southern boundary of the property. The city granted the plaintiffs a variance from lot size requirements, in exchange for which plaintiffs dedicated ownership of the property underlying the street to the city. The plaintiffs later made a claim for lost profits, holding costs, and lost interest income as a result of the encroachment of the street. The trial court held that the encroachment affected the market value of the property, not marketability of title, and thus found no coverage under the title policy. The appellate court reversed, holding that the encroachment did not render plaintiffs' title unmarketable as a matter of law, but further holding that whether plaintiffs' title was unmarketable was a question of fact. 93 CA4th at 695. The court noted that in many cases, marketability can be determined as a matter of law, such as when the encroachment is so insignificant that the owner would not be required to pay more than nominal damages for the error. See *Mertens v Berendsen* (1931) 213 C 111, 115, 1 P2d 440 (encroachment of two- to seven-eighths of an inch on the insured property. However, the *Mellinger* court held that the title insurer had not proven that the city's claim had no merit and did not affect the marketability of title.

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§11.63 c. Lien

The second provision of the CLTA policy, the 1992 ALTA owner's and lender's policies, and the 2006 ALTA owner's and lender's policies also protects the insured against any "lien" on the title, but the policies do not define "lien." See §6.23. The court in *Elysian Inv. Group v Stewart Title Guar. Co.* (2002) 105 CA4th 315, 129 CR2d 372, impliedly adopted the CC §1180 definition of "lien" as "a charge imposed upon specific property by which it is made security for the performance of an act." See also *Lick Mill Creek Apartments v Chicago Title Ins. Co.* (1991) 231 CA3d 1654, 1663, 283 CR 231 (contaminants on property affecting its market value do not constitute a "lien").

In *Elysian Inv. Group v Stewart Title Guar. Co., supra,* the court held that the notice was not a lien affecting title. The court found that the city might place a lien on the property in the future if the owner did not bring the property into compliance with building ordinances. However, the court held that the title policy does not insure against future events, but only against defects in title existing at the time when the policy was issued. 105 CA4th at 320. See §11.62 for further discussion of *Elysian.*

In *Bulmash v Davis* (1979) 24 C3d 691, 694, 157 CR 66, Davis commenced an action on a promissory note against the Kays. Judgment was entered in favor of Davis, who recorded a judgment lien. The judgment was vacated, however, and Davis appealed. While the appeal was pending, the Kays sold a house against which the lien had been recorded to Bulmash. A "preliminary title report" issued by the insurer did not mention the Davis judgment. Later, the appellate court ordered the vacated Davis judgment reinstated, and Davis levied on the property. Bulmash then filed a quiet title action. The trial court held that Bulmash had obtained title free and clear of all encumbrances because the judgment lien had no legal effect between the date of the order vacating the judgment and the date the judgment was reinstated. The appellate court affirmed, holding that the judgment lien could not exist without the judgment on which it was based and that the judgment lien could not be restored retroactively.

NOTE: *Bulmash* underscores the fact that a title insurance policy insures title at a given moment in time. For the policy to insure against a lien, the lien must exist on the effective date of the policy.

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§11.64 d. Encumbrance

The second provision of the CLTA policy, the 1992 ALTA owner's and lender's policies, and the 2006 ALTA owner's and lender's policies also insures against an encumbrance on title. Notably, the policies do not define "encumbrance." See §6.23. An encumbrance has been defined as "any right to, or interest in, land which may subsist in another to the diminution of its value, but consistent with the passing of the fee." *Elysian Inv. Group v Stewart Title Guar. Co.* (2002) 105 CA4th 315, 320, 129 CR2d 372. Encumbrances include taxes, assessments, and all liens on real property. CC §1114; *1119 Delaware v Continental Land Title Co.* (1993) 16 CA4th 992, 999 n4, 20 CR2d 438.

In *Lick Mill Creek Apartments v Chicago Title Ins. Co*. (1991) 231 CA3d 1654, 1663, 283 CR 231, the court concluded that the mere presence of contaminants, which affected the market value of the property against which no lien had been recorded or asserted, did not constitute an "encumbrance." The court cited with approval language in *U.S. v Allied Chem. Corp.* (ND Cal 1984) 587 F Supp 1205, 1206, which interprets "encumbrance" to include only liens, easements, restrictive covenants, and other such interests or rights to the land held by third persons.

In *1119 Delaware,* 16 CA4th at 999, the court held that a conditional use permit was an encumbrance on title within the insuring clause of a title policy because the permit in question limited the owner's right to freely use or transfer the property. Notably, the conditional use permit had been recorded under Govt C §27281.5, which provides that a restriction imposed by a governmental entity must be recorded to be valid and that the recording provides constructive notice of its existence.

A recording of a "notice of buildings, structures, or premises classified as either hazardous, substandard or a nuisance does not constitute a "defect in or lien or encumbrance on the title." *Elysian Inv. Group v Stewart Title Guar. Co., supra*. See §11.62 for further discussion of *Elysian.*

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§11.65 e. Lack of Access

The fourth provision of the CLTA policy, the 1992 ALTA owner's and lender's policies, and the 2006 ALTA owner's and lender's policies insures against the lack of a right of access to the land. See cases cited in §6.27 interpreting the scope of coverage afforded for lack of access.

In *Magna Enters., Inc. v Fidelity Nat'l Title Ins. Co.* (2002) 104 CA4th 122, 127 CR2d 681, the court held that such a provision insures against only a lack of *legal* right to access, not a lack of physical or practical access. In *Magna,* the plaintiff bought adjacent commercial parcels. An auto repair center on one parcel had no practical way of access from the public street. Street access to the repair center was gained through an easement through liquor store property. After that easement had been granted by the liquor store owner, the plaintiff's predecessor had granted the liquor store a parking easement. Eventually, the liquor store owner sued the plaintiff for trespass and nuisance, claiming that the ingress-egress easement unlawfully interfered with the use of the parking easement. In turn, the plaintiff sued its title insurer for breach of contract and bad faith. The court of appeal held that there was no coverage under the title policy. The court noted that because the plaintiff owned abutting shopping center property, it had a right to access the repair center property, finding that difficulty of physical access caused by a fence and elevation differences did not establish lack of legal right to access.

In *Lincoln Sav. & Loan Ass'n v Title Ins. & Trust Co.* (1975) 46 CA3d 493, 120 CR 219, the court applied a similar exclusion that precluded coverage for loss or damage caused by reason of "title to streets… or any rights or easements therein… except that if the land abuts upon one or more physically open streets or highways, this policy insures the ordinary rights of abutting owners for access to one of such streets or highways." 46 CA3d at 496.

In *Lincoln*, the insured owned two lots, which did not abut the street. The insured had purchased easements for both lots across an adjoining parcel, but deed restrictions in a recorded declaration prevented use of the easements as driveways, rendering the lots inaccessible. The court held that the policy insured only the owner's ordinary rights in land abutting a physically open street and that the policy did not otherwise insure the owner's rights of access to that street. In other words, because the lots did not abut the street, the court applied the exclusion and found no coverage for the insured's loss. 46 CA3d at 497.

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§11.65A f. Property Dimensions

CLTA Endorsement 116 insures that the character of improvements are as stated in the policy and that the street address, dimensions, and location of the insured land as shown on a map attached to the policy are accurate. See discussion at §§8.93-8.94. In *Golden Sec. Thrift & Loan Ass'n v First Am. Title Ins. Co.* (1997) 53 CA4th 250, 61 CR2d 442, the policy included this endorsement. The map attached to the policy correctly depicted the length of each boundary line, but incorrectly listed the area of the property as 2.06 acres "more or less." In fact, the parcel contained approximately 1.36 acres. On a claim against the policy brought by the lender after foreclosing, the trial court granted summary judgment in favor of the insurer, holding that the term "dimension" in Endorsement 116 was not ambiguous and referred to length and width, not to "area." The appellate court affirmed, agreeing that the terms "dimensions" and "area" connote discrete concepts. For additional discussion of the *Golden Sec.* case, see §11.48.

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§11.65B g. Covered Risks Under 1992 ALTA Residential Policy and CLTA/ALTA Homeowner's Policies

In contrast to the four covered risks applicable to *owners* under the 1990 CLTA Standard Coverage Policy (see App H) and the three covered risks applicable to *lenders* under that policy, the 1992 ALTA Residential Title Policy (see App M) sets forth 14 covered risks, and the CLTA/ALTA Homeowner's Policies (see App O) sets forth either 29 or 32 covered risks, depending on the year of the policy. Although many of the enumerated covered risks in the Residential Title Policy and the Homeowner's Policies overlap those in the Standard Coverage Policy, some appear to expand the scope of coverage. For example, Covered Risk 7 of the Homeowner's Policy extends the first six covered risks to risks that occur after the Policy Date; there is no comparable provision in the Standard Coverage Policy. Other enumerated covered risks may arguably restrict coverage. For example, whereas the Standard Coverage Policy refers to a "lack of right of access," Covered Risk 11 of the 1998 and 2003 Homeowner's Policies requires lack of "both vehicular and pedestrian access." A question then arises whether there is no coverage if the insured had pedestrian, but not vehicular, access. The word "both" has been removed from the 2008 policy.

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§11.66 2. Lack of Proximate Cause

In general, when an insured risk is not the proximate cause of the insured's loss, a claim under the title policy has no basis. *Brown v Title Ins. & Trust Co.* (1921) 51 CA 65, 72, 196 P 114.

If an insured loses its interest in the property by foreclosure and if no proximate causal connection exists between the insured's loss and an undisclosed title defect, the loss is not covered. *Sala v Security Title Ins. & Guar. Co.* (1938) 27 CA2d 693, 702, 81 P2d 578; *Metropolitan Title Guar. Co. v Gildenhorn* (DC Cir 1957) 249 F2d 933, 935.

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§11.67 B. Exclusions

The exclusions discussed in §§11.68-11.78 are generally found in the form title policies commonly used in California: the 1990 CLTA Standard Coverage Policy, 1992 ALTA Lender's Policy, 2006 ALTA Lender's Policy, 1992 ALTA Owner's Policy, 2006 ALTA Owner's Policy, and the CLTA/ALTA Homeowner's Policies (see Apps H, I, J, K, L, and O, respectively). Both standard and extended coverage policies contain these exclusions unless a special endorsement is negotiated to override or delete the exclusion. They generally follow the section of the policy setting forth the covered risks. They are significant because the insurer has no obligation to indemnify or defend the insured for loss or damage caused by these matters. For discussion of the same exclusions from a transactional perspective, see §§6.34-6.48. For a general description of the CLTA and ALTA policies containing these exclusions, see §§6.7-6.11.

The 1992 ALTA Residential Policy (see App M) and the CLTA/ALTA Homeowner's Policies (see App O) contain exclusions similar to those in the 1990 CLTA Standard Coverage Policy, 1992 and 2006 ALTA Lender's Policies, and 1992 and 2006 ALTA Owner's Policies. However, the Residential Policy and the Homeowner's Policies contain an additional exclusion barring coverage for lack of a right to any land outside the area specifically described and referred to in the legal description of the land covered by the policy, and in streets, alleys, or waterways that touch the land. The authors are not aware of any reported cases interpreting this exclusion.

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§11.68 1. Law, Ordinance, or Government Regulation

Under Exclusion 1(a) of the CLTA Standard Coverage Policy, the 1992 ALTA lender's and owner's policies, and (under similar language in) the 2006 ALTA lender's and owner's policies (see §11.67), coverage is precluded for any loss, damage, costs, attorney fees, or expenses arising from:

> Any law, ordinance, or governmental regulation (including, but not limited to, building or 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.

See examples and discussion in §§6.36, 6.38.

In *Elysian Inv. Group v Stewart Title Guar. Co.* (2002) 105 CA4th 315, 129 CR2d 372, the plaintiff alleged that the title company breached the title insurance policy by failing to inform the plaintiff that a "Notice of Premises Classified as Substandard" had been recorded against the insured property. The appellate court affirmed summary judgment for the title company, noting that, unlike an assessment lien, the notice did not affect title. The court noted that the insured could not rely on the exception to the ordinance or law exclusion to extend coverage, holding that even if the exclusion could be understood as granting coverage based on the reasonable expectation of the insured, the notice did not fall within the exception to the exclusion. The notice was not a notice of enforcement but was a warning, preliminary to any formal enforcement action.

In *Hocking v Title Ins. & Trust Co.* (1951) 37 C2d 644, 652, 234 P2d 625, the insured purchased a lot, intending to improve it. She obtained a title policy describing the property as two separate lots as shown on a subdivision map. However, because the vendor had failed to comply with certain requirements, she could not obtain a building permit to develop the property. When she sued the title insurer, the trial court ruled that the claim was not covered, because the facts did not bring it within the ambit of the insuring language of the policy. See §11.62. The supreme court affirmed and noted in passing that the insured disclaimed any contention that the city's refusal to issue building permits constituted an actionable claim under the title policy. The court noted that, if the insured had so contended, the exclusion precluding coverage for governmental acts or regulations would have applied. 37 C2d at 647 n4.

In *Nishiyama v Safeco Title Ins. Co.* (1978) 85 CA3d Supp 1, 4, 149 CR 355, after the insureds purchased property and obtained a title insurance policy, they learned that the seller had violated the Subdivision Map Act (Govt C §§66410-66499.37). The insureds sued Safeco to recover on the policy. The trial court sustained a demurrer to their claim, on two grounds, finding that (1) noncompliance with the Act did not render title unmarketable and (2) any damage caused by noncompliance came under the exclusion precluding coverage for loss or damage from any law, ordinance, or governmental regulation. Notably, the appellate court affirmed, on the first ground only, and thus did not reach the issue of the applicability of the exclusion.

However, in *1119 Delaware v Continental Land Title Co.* (1993) 16 CA4th 992, 1003, 20 CR2d 438, the court held that a conditional use permit (CUP) was not a "law, ordinance, or governmental regulation" within the meaning of this exclusion. The court noted that a CUP represents a bargain between a public entity and a permittee with respect to a particular parcel of real property: In exchange for development and land use permits under the CUP, the permittee agrees to meet specified conditions required by the public entity. The court stated (16 CA4th at 1002):

> In view of the fact a CUP is not a law of general application which is readily ascertainable, a prospective buyer is entitled to resort to an abstract of title to learn of the existence of a CUP which has been recorded against a property. Continental's attempt to equate the instant CUP with a law of general application, such as an ordinance or land use regulation, is unavailing.

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§11.69 2. Police Power

Exclusion 1(b) of the CLTA policy and the 1992 ALTA lender's and owner's policies (see §11.67) precludes coverage for any loss, damage, costs, attorney fees, or expenses arising from:

> 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.

Exclusion 1(b) of the 2006 ALTA lender's and owner's policies precludes coverage for any loss, damage, costs, attorney fees, or expenses arising from "[a]ny governmental police power. This exclusion 1(b) does not modify or limit the coverage provided under Covered Risk 5."

The authors are not aware of any California cases interpreting the police power exclusion. Notably, in *Lick Mill Creek Apartments v Chicago Title Ins. Co.* (1991) 231 CA3d 1654, 1665, 283 CR 231, the court declined to rule on the applicability of this exclusion because it found no coverage under the insuring language of the policy. See §6.37.

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§11.70 3. Eminent Domain

Exclusion 2 of the CLTA policy and the 1992 ALTA lender's and owner's policies (see §11.67) precludes coverage for any loss, damage, costs, attorney fees, or expenses arising from:

> 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.

Exclusion 2 of the 2006 ALTA lender's and owner's policies precludes the same coverage. The exceptions to Exclusion 2 in the CLTA and the 1992 ALTA policies have been made Covered Risks 7 and 8 in the 2006 ALTA policies.

The authors are not aware of any California cases interpreting the eminent domain exclusion. See §6.39.

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4. Defects, Liens, Encumbrances, Adverse Claims, and Other Matters

§11.71 a. Matters Created, Suffered, Assumed, or Agreed to by Insured

Exclusion 3(a) of the CLTA policy precludes coverage for loss, damage, costs, attorney fees, or expenses that arise through defects, liens, encumbrances, adverse claims, or other matters "whether or not recorded in the public records at Date of Policy, but created, suffered, assumed, or agreed to by the insured claimant." Exclusion 3(a) of the 1992 and 2006 ALTA owner's and lender's policies (see §11.67) contains a similar exclusion, which omits the language "whether or not recorded in the public records at Date of Policy." See examples in §6.41.

In *Hansen v Western Title Ins. Co.* (1963) 220 CA2d 531, 535, 33 CR 668, the court found this exclusion to be ambiguous. It held that the term "created" should be construed as requiring conscious, deliberate causation and that "suffered" could be interpreted as "consented." The court concluded that the insured's actions, in signing an ambiguous holding agreement prepared by the insurer, which agreement was subject to an interpretation that the insured did not intend, did not fall within this exclusion. The court limited its ruling to cases "in which the insured did not intentionally produce the claim and in which the insurer itself had opportunity to know of the defect." 220 CA2d at 536. See also *First Nat'l Bank v Fidelity Nat'l Title Ins. Co.* (8th Cir 1978) 572 F2d 155, 162 (exclusion does not preclude coverage unless insurer establishes that insured lender knowingly agreed that its mortgage would occupy junior position to senior mortgage).

In contrast, in *Safeco Title Ins. Co. v Moskopoulos* (1981) 116 CA3d 658, 667, 172 CR 248, even though the exclusion was found ambiguous, construing it narrowly against the insurer did not result in coverage for the claim. Thus, even construing the exclusion narrowly, the insured's conduct in filing a specific performance action and recording a lis pendens to force a sale to the insured fell within the terms of the exclusion, precluding any duty to defend or indemnify. The court distinguished the result in *Hansen* because the insured's conduct in *Safeco* was deliberate and intentional, not inadvertent.

In *Nishiyama v Safeco Title Ins. Co.* (1978) 85 CA3d Supp 1, 6 n6, 149 CR 355, the court stated in dicta that, if the insured had purchased the property with knowledge of violations of the Subdivision Map Act, the exclusion for defects "created, suffered, assumed, or agreed to by the insured claimant" would also have precluded coverage. See §11.68.

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§11.72 b. Matters Neither Known to Insurer Nor Recorded in Public Records, But Known to Insured

Exclusion 3(b) of the CLTA policy, the 1992 and 2006 ALTA owner's policies, and the 1992 and 2006 ALTA lender's policies (see §11.67) precludes coverage for loss, damage, costs, attorney fees, or expenses that arise from defects, liens, encumbrances, adverse claims, or other matters not known to the insurance company and 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 claimant before the date the claimant became an insured under the policy. See §6.42.

In *Stearns v Title Ins. & Trust Co.* (1971) 18 CA3d 162, 95 CR 682, Stearns was sued by a neighbor alleging that Stearns's improvements encroached onto his property. Stearns demanded that the title insurer defend the case, and when the insurer refused, Stearns sued the insurer. The policy contained an exclusion precluding coverage for defects known to the insured on the date of policy and not shown by the public records. 18 CA3d at 167. The insured knew of the boundary question seven years before the policy had been issued, but argued that because the dispute was based on discrepancies in three surveys, which had all been recorded, the exclusion did not apply. The appellate court disagreed and affirmed the judgment, holding that the insurer had no duty to defend. It concluded that "public records" includes only records that impart constructive notice and that the statutes under which the surveys were recorded did not provide for constructive notice, and thus the surveys were not "public records" under the policy. 18 CA3d at 169. See §11.83 for further discussion of *Stearns*.

In contrast, in *Paramount Props. Co. v Transamerica Title Ins. Co.* (1970) 1 C3d 562, 571, 83 CR 394, the title insurer refused to defend a third party action, relying in part on the exclusion precluding coverage for defects not known to the insurer, but known to the insured. The supreme court found that the exclusion was expressly limited to knowledge possessed by the insured either as of the date of the policy or the date the insured acquired an interest or estate insured by the policy. After reviewing the evidence, the court concluded that the insurer had a clear duty to defend.

Although not referring directly to any exclusionary language, the court in *J. H. Trisdale, Inc. v Shasta County Title Co.* (1956) 146 CA2d 831, 838, 304 P2d 832, held that it was a question of fact whether an insured had actual notice of circumstances sufficient to trigger a duty to investigate an easement reflected in a title policy, because the policy does not impart "constructive notice" of a matter of record that is inaccurately described in the preliminary report and the policy.

Although the opinion does not mention this exclusion, in *Coleman v Security Title Ins. Co.* (1963) 218 CA2d 444, 445, 32 CR 575, the insurer issued a policy stating that the property was located in a certain irrigation district and a city, whereas the property was not actually within either the district or the city limits. The appellate court affirmed the judgment in the insurer's favor, partly because of the fact that the insureds knew that the land was not located in the city. See §11.62.

In *Vernon v Title Guar. & Trust Co.* (1935) 7 CA2d 171, 46 P2d 191, Vernon, an attorney, brought an action for a client against Hamilton, knowing that Hamilton was mentally and physically incompetent. Vernon obtained a default judgment and executed against Hamilton's real property, which was sold to a woman whom Vernon later married. Vernon then obtained a title insurance policy from defendant Title Guarantee in his wife's name. When Hamilton's guardian sued to void the sale, the Vernons tendered defense of the suit. The defendant refused to defend, based in part on the exclusion precluding coverage for defects known to the insured to exist on the date of policy and not disclosed in writing to the insurer. Following a lawsuit by Vernon's wife against the insurer and judgment in the insurer's favor, the wife appealed.

The appellate court affirmed, noting that the insurer had no knowledge of the facts underlying the claim. The court also held that the insured had used Vernon as her "alter ego" to obtain the policy and that, because Vernon knew all the facts and was the insured's agent and attorney, as well as her husband, the insured was "deemed to have notice of those matters" of which Vernon had notice. 7 CA2d at 174.

In *Nishiyama v Safeco Title Ins. Co.* (1978) 85 CA3d Supp 1, 149 CR 355, the court stated in dicta that, if the insureds had purchased the insured property with knowledge of the vendor's violations of the Subdivision Map Act

(Govt C §§66410-66499.37), coverage would have been precluded, among other grounds, by the exclusion for defects not shown by the public records and not otherwise excluded from coverage, but known to the insured. 85 CA3d Supp at 6 n6. See §11.68.

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§11.73 c. Matters Resulting in No Loss or Damage to Insured

Exclusion 3(c) of the CLTA policy, the 1992 and 2006 ALTA owner's policies, and the 1992 and 2006 ALTA lender's policies (see §11.67) precludes coverage for any loss, damage, costs, attorney fees, or expenses arising from defects, liens, encumbrances, adverse claims, or other matters that result "in no loss or damage" to the insured claimant. See examples in §6.43.

In *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 275 CR 107, Cale was an insured lender who believed he held a second deed of trust. The policy excepted from coverage the first deed of trust, but did not list three other senior liens as exceptions. After the borrowers defaulted, Cale learned of the undisclosed liens and filed a claim with the insurer for the anticipated costs of removing them. When the insurer advised Cale that his loss could not be established before the completion of foreclosure, Cale foreclosed and purchased the property for $1 at the trustee's sale. The insurer again denied that Cale had been damaged and Cale sued the insurer for bad faith. The trial court granted the insurer's motion for summary judgment.

The appellate court affirmed, finding that Cale had suffered no actual loss. Title insurance provides indemnity to a lender only to the extent that it is unable to collect the debt, not wholesale protection from "diminution of profits potentially obtainable from resale of the property." 225 CA3d at 427. See §11.13. The opinion does not state whether the court based its decision on an interpretation of the language insuring against loss or damage resulting from the priority of the senior liens or on the exclusion precluding coverage for defects "resulting in no loss or damage to the insured claimant."

In *Hawkins v Oakland Title Ins. & Guar. Co.* (1958) 165 CA2d 116, 122, 331 P2d 742, a title policy issued to the new owners indemnified "against loss or damage" from any defect in title and excluded coverage for defects that "result in no pecuniary loss to the insured." The owners built a service station on the property and exchanged title to it for shares in a corporation. Thereafter, they discovered a recorded deed (apparently from a prior owner) limiting access rights to the property, which deed was not excepted from coverage under the policy. The insureds sued their insurer, contending that they were damaged in the amount of the purchase price and what they spent to build the service station.

The insurer argued that the insureds had not been damaged, because they had exchanged the property for stock of a par value equal to the value of the land, plus the costs of building the service station. The insureds contended that the value of the stock reflected the value of the corporate assets, and if the assets were depressed in value through a defect in the title of the property, the value of their stock was similarly depressed. 165 CA2d at 122. The court ruled that the demurrer had properly been sustained because it could not be ascertained from the complaint whether the insureds had suffered a loss, noting that the service station might be just as valuable even though the only access was through a service road. The court also ruled that the plaintiffs should have been given leave to amend to allege that they had been damaged.

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§11.74 d. Matters Attaching or Created After Date of Policy

Exclusion 3(d) of the CLTA policy, the 1992 and 2006 ALTA owner's policies, and the 1992 and 2006 ALTA lender's policies (see §11.67) precludes coverage for any loss, damage, costs, attorney fees, or expenses that arise because of defects, liens, encumbrances, adverse claims, or other matters "attaching or created subsequent to Date of Policy." Exclusion 3(d) in the 1992 ALTA lender's policy qualifies this exclusion by insuring the priority of an insured lender's lien over certain mechanics' liens; Exclusion 3(d) of the 2006 ALTA lender's policy contains substantially the same limitation by referring to Covered Risks 11, 13, and 14. The effect of the qualifying language is that the basic ALTA lender's policies exclude coverage for mechanics' liens for improvements contracted for or commenced after the date of policy and not financed by the insured lender, but do insure against mechanics' liens for improvements either contracted for (or commenced) before the date of policy or financed by the insured lender. See §§6.30, 6.44, 8.30.

Although the authors are not aware of any California case interpreting this exclusion, it underscores the unique nature of title insurance. Compared with other types of insurance, which protect against losses during a policy period that may span several months or a year and that must be renewed periodically for an additional premium, title insurance insures the condition of title at a particular moment on a particular day. See generally *Rosen v Nations Title Ins. Co.* (1997) 56 CA4th 1489, 1500, 66 CR2d 714 (insuring language limits coverage to title defects existing at time policy is issued). The "Date of Policy" is found in Schedule A in the CLTA policy and the ALTA policies.

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§11.75 e. Loss That Would Not Have Occurred If Insured Had Paid Value

Exclusion 3(e) in the 2006 and 1992 ALTA lender's policies excludes coverage for loss, damage, costs, attorney fees, or expenses arising from defects, liens, encumbrances, adverse claims, or other matters resulting in loss or damage which would not have been sustained if the insured claimant had paid value for the insured mortgage. Exclusion 3(e) in the 1992 ALTA owner's policy precludes coverage for the same matters "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*" (emphasis added). Likewise, Exclusion 3(e) in the 2006 ALTA owner's policy precludes coverage for the same matters "resulting in loss or damage that would not have been sustained if the Insured Claimant had paid value *for the Title*" (emphasis added). See example in §6.45. Exclusion 3(e) in the CLTA policy essentially combines terms from both of the 1992 ALTA policies because the CLTA form, a joint protection policy, is used to insure both lenders and owners.

In *Nishiyama v Safeco Title Ins. Co.* (1978) 85 CA3d Supp 1, 149 CR 355, the insureds contended that they suffered a loss covered by their title policy because the sellers had violated the Subdivision Map Act (Govt C §§66410-66499.37) and they could not resell the property. The appellate court denied coverage based on the insuring language (see §11.68). However, in dicta the court stated that, if the insureds had purchased the property with knowledge of the violation of the Subdivision Map Act, the policy exclusion precluding coverage for defects "resulting in loss or damage which would not have been sustained if the insured claimant had been a purchaser or encumbrancer for value without knowledge" would have precluded coverage. 85 CA3d Supp at 6 n6.

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§11.76 5. Unenforceability of Lien for Failure to Comply With Doing-Business Laws

Exclusion 4 of the CLTA policy and the 1992 ALTA lender's policy (see §11.67) precludes coverage for loss, damage, costs, attorney fees, or expenses arising from:

> Unenforceability of the lien of the insured mortgage because of the inability or failure of the insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with applicable doing business laws of the state in which the land is situated.

Exclusion 4 of the 2006 ALTA lender's policy contains similar language extending to "*an Insured,*" thereby including a subsequent owner of the indebtedness:

> Unenforceability of the lien of the Insured Mortgage because of the inability or failure of an Insured to comply with applicable doing-business laws of the state where the Land is situated.

The 1992 and 2006 ALTA owner's policies have no comparable exclusion, because they do not insure lenders.

The authors are unaware of any California cases interpreting this exclusion. See §6.46. California's "doing-business" compliance statutes are in Corp C §§2105, 2203.

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§11.77 6. Invalid or Unenforceable Lien for Violation of Usury, Consumer Credit, or Truth in Lending Laws

Exclusion 5 of the CLTA policy and the 1992 ALTA lender's policy (see §11.67) precludes coverage for any loss, damage, costs, attorney fees, or expenses that arise from:

> Invalidity or unenforceability of the lien of the insured mortgage, or claim thereof, which arises out of the transaction evidenced by the insured mortgage and is based upon usury or any consumer credit protection or truth in lending law.

Exclusion 5 of the 2006 ALTA lender's policy contains similar language:

> Invalidity or unenforceability in whole or in part of the lien of the Insured Mortgage that arises out of the transaction evidenced by the Insured Mortgage and is based upon usury or any consumer credit protection or truth-in-lending law.

The 1992 and 2006 ALTA owner's policies have no comparable exclusion, because they do not insure lenders.

The authors are not aware of any cases interpreting this exclusion to preclude coverage for loss or damage arising from failure to comply with a consumer credit protection or truth in lending law. See §6.46. The following California appellate decision may provide some assistance in interpretation. In *Moe v Transamerica Title Ins. Co.* (1971) 21 CA3d 289, 98 CR 547, the court discussed usury, but not in the context of this exclusion. In *Moe*, a title insurance company was found to have engaged in a fraudulent conspiracy to induce the plaintiffs to purchase a worthless note secured by an equally valueless deed of trust. The company sought to avoid liability by contending that the plaintiffs were guilty of usury because they had lent $80,000 in return for a flat note for $102,000, payable in nine months. The company calculated this amount to be 34 percent interest annually. The court rejected that argument, finding that the plaintiffs had merely intended to purchase a note at a discount, which is not prohibited by the usury law. 21 CA3d at 299.

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§11.78 7. Claims Arising From Bankruptcy, Insolvency, or Creditor's Rights Law

Exclusion 6 of the CLTA policy precludes coverage for any loss, damage, costs, attorney fees, or expenses arising from:

> Any claim, which arises out of the transaction vesting in the insured the estate or interest insured by this policy or the transaction creating the interest of the insured lender, by reason of the operation of federal bankruptcy, state insolvency or similar creditors' rights laws.

The ALTA policies contain similar but narrower exclusions (see §11.67). Exclusion 7 in the 1992 ALTA lender's policy precludes coverage for:

> Any claim, which arises out of the transaction creating the interest of the mortgagee 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 interest of the insured mortgagee being deemed a fraudulent conveyance or fraudulent transfer; or
> (b) the subordination of the interest of the insured mortgagee as a result of the application of the doctrine or equitable subordination; or
> (c) the transaction creating the interest of the insured mortgagee 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.

Exclusion 6 of the 2006 ALTA lender's policy contains similar, but simplified, language. The exception to Exclusion 7(c) in the 1992 ALTA lender's policy has been moved to become Covered Risk 13(B) of the 2006 ALTA lender's policy. In addition, the reference to equitable subordination was deleted, as that issue is addressed in Exclusion 3 of the 2006 ALTA lender's policy.

Exclusion 4 of the 1992 ALTA owner's policy precludes coverage for:

> 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:
> (i) the transaction creating the estate or interest insured by this policy being deemed a fraudulent conveyance or fraudulent transfer; or
> (ii) 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:
> (a) to timely record the instrument of transfer; or
> (b) of such recordation to impart notice to a purchaser for value or a judgment or lien creditor.

Exclusion 4 of the 2006 ALTA owner's policy contains similar, but simplified, language. Further, the exceptions to Exclusion 4(b) of the 1992 ALTA owner's policy have been moved to become Covered Risk 9(b) of the 2006 ALTA owner's policy.

NOTE: The authors are not aware of any California cases interpreting this exclusion, the parameters of which are the subject of much discussion among practitioners. See §6.48.

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§11.79 D. Standard (Preprinted) Exceptions

The standard, preprinted exceptions discussed in §§11.80-11.84 are usually found in the 1990 CLTA policy, which is, by nature, a standard coverage policy. See §§6.7, 6.51. They may also be added to an ALTA lender's or owner's policy to convert the ALTA policy from an extended coverage to a standard coverage policy. See §§6.50, 6.53. These exceptions are located in Schedule B, Part I of the CLTA policy, and when used in the ALTA policies they are added to Schedule B. They are similar to exclusions (see §11.67) in their effect on coverage; *i.e.*, the insurer has no obligation to indemnify or defend the insured for loss or damage caused by the matters listed as exceptions. They differ in that preprinted exceptions are used only in standard coverage policies, while exclusions are listed in both standard and extended coverage policies. See §6.34. For a general description of the CLTA and ALTA policies containing these exceptions, see §§6.50-6.54.

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§11.80 1. Taxes or Assessments, Public Agency Proceedings

Exception 1 of the ALTA and CLTA standard coverage policies (see §11.79) precludes coverage for loss or damage, stating that the insurer will not pay costs, attorney fees, or expenses that arise from:

> Taxes or assessments which are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the public records.
>
> Proceedings by a public agency which may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the public records.

The authors are not aware of any California cases interpreting this exception.

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§11.81 2. Facts, Rights, Interests, or Claims Not Shown by Public Records But Ascertainable by Inspection of Land or Assertion by Persons in Possession

Exception 2 of the 1992 ALTA and CLTA standard coverage policies (see §11.79) precludes coverage for loss or damage and states that the insurer will not pay costs, attorney fees, or expenses that arise from any "facts, rights, interests, or claims which are not shown by the public records but which could be ascertained by an inspection of the land or which may be asserted by persons in possession." Exception 2 of the 2006 ALTA policies is substantially similar.

This exclusion was unsuccessfully used as a defense by a title insurer sued for not taking reasonably diligent steps to remove a title defect. In *Nebo, Inc. v Transamerica Title Ins. Co.* (1971) 21 CA3d 222, 98 CR 237, Nebo entered into an exchange agreement for 17 improved lots that had a history of unresolved title claims adverse to the interest of Nebo. Defendant Transamerica was fully aware of the claims and issued a title policy to Nebo who was unaware of the claims. After the close of escrow, tenants on 4 lots refused to pay their rent to Nebo and instead paid an adverse claimant. On demand by Nebo, Transamerica agreed to clear title to the lots, but did not accomplish this until 3½ years after escrow had closed. 21 CA3d at 224. See §12.52.

Nebo then sued Transamerica for breach of the insurance agreement. Transamerica argued, among other things, for application of the exclusion precluding coverage for claims not shown by public records, "but which could be ascertained by an inspection or by making inquiry of persons in possession." It argued that Nebo's loss resulted from its inability to secure possession of the lots because of the tenants' possessory rights, not from title defects, and that Nebo could have ascertained the tenants' possessory rights by a simple inquiry. 21 CA3d at 227. The appellate court criticized the insurer's argument as specious and affirmed the trial court's finding that Transamerica had not perfected Nebo's title within a reasonable time. The court stated that Nebo's lack of legal entitlement to the rents arose from the defect in title, which was of record, and not from the unrecorded possessory rights of the tenants, and held that the exclusion did not apply. 21 CA3d at 227.

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§11.82 3. Easements, Liens, Encumbrances, or Claims Not Shown by Public Records

Exception 3 of the ALTA and CLTA standard coverage policies (see §11.79) precludes coverage for loss or damage, stating that the insurer will not pay costs, attorney fees, or expenses that arise from easements, liens, or encumbrances, or claims thereof, not shown by the public records.

A third party action against an insured owner seeking a right to an easement "by prescription, implication, balancing of hardships, and estoppel" was excepted from coverage under Exception 3, because such easement would not appear in the public records. Accordingly, the title insurer had no duty to defend the third party action. *Bailey v State Farm Ins. Co.* (ND Cal 1992) 810 F Supp 267, 271.

In *Native Sun Inv. Group v Ticor Title Ins. Co.* (1987) 189 CA3d 1265, 235 CR 34, the State of California claimed an interest in the insured's property through so-called *Gion-Dietz* claims. See §12.50. Such claims involve implied public dedication of property rights as a result of historic public use. The insurer prosecuted a quiet title action on the insured's behalf but informed the insured that it would not indemnify it for any loss caused by the state's enforcement of *Gion-Dietz* rights, because claims for such loss were exempt from coverage by exception 3. The appellate court held that the *Gion-Dietz* claims were not covered, because nothing in the record indicated that title was in any way unmarketable on the effective date of the policy. Accordingly, the court did not reach the issue of whether exception 3 applied. 189 CA3d at 1275.

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Source: Real Property/California Title Insurance Practice/11 Theories and Defenses in Title Company Actions/§11.83 4. Information Not Shown in Public Records That Correct Survey Would Reveal

§11.83 4. Information Not Shown in Public Records That Correct Survey Would Reveal

Exception 4 of the ALTA and CLTA standard coverage policies (see §11.79) precludes coverage for loss or damage, stating that the insurer will not pay costs, attorney fees, or expenses that arise from "[d]iscrepancies, conflicts in boundary lines, shortage in area, encroachments, or any other facts which a correct survey would disclose, and which are not shown by the public records" (CLTA and 1992 ALTA lender's and owner's policies) or "[a]ny encroachment, encumbrance, violation, variation, or adverse circumstance affecting the Title that would be disclosed by an accurate and complete land survey of the Land and not shown by the Public Records" (2006 ALTA lender's and owner's policies).

In *Stearns v Title Ins. & Trust Co.* (1971) 18 CA3d 162, 95 CR 682, a neighbor sued the insured for trespass, alleging that the insured's improvements encroached on the neighbor's property. Three separately recorded surveys contained inconsistent information about the boundaries. After tendering defense of the action to his title insurer, which refused to defend, the insured sued the insurer for breach of contract. The trial court ruled that the insurer had no duty to defend, and the appellate court affirmed. The policy contained an exclusion that precluded coverage for loss or damage caused by discrepancies, conflicts in boundary lines, shortages in area, encroachments, or any other facts that a correct survey would disclose and that were not shown by the public records. The appellate court noted that a correct survey would have resolved the conflict in boundary lines (18 CA3d at 168) and held that the exclusion applied because the discrepancy or conflict was not disclosed by the public records within the meaning of the policy (18 CA3d at 169).

The court found the term "public records" to be clearly defined in the policy as records that impart constructive notice. Even though three surveys of the property had been recorded, the court held that they were not the type of public records that impart constructive notice. The court noted that a recorded document does not give constructive notice unless a statute expressly provides that the effect of such recording is to give constructive notice. Because the statutes under which the surveys had been recorded did not so provide, the surveys were not public records under the policy. 18 CA3d at 169. See §11.72 for additional discussion of *Stearns*.

In *Overholtzer v Northern Counties Title Ins. Co.* (1953) 116 CA2d 113, 253 P2d 116, the insureds purchased property and a title insurance policy. After building a sawmill, a neighbor claimed a pipeline easement across the property. The insureds read their title policy, noted that it did not refer to an easement for the pipeline and, relying on the policy, cut the pipeline. The neighbor sued, resulting in an injunction prohibiting the insureds from interfering with the pipeline. The insureds then made a claim against their title policy for diminution in value of their land because of the pipeline easement. When the insurer rejected their claim, the insureds sued. The trial court decided in the insureds' favor, and the appellate court affirmed.

The insurer argued on appeal for application of the exclusion precluding coverage for "any facts which a correct survey and inspection… would show." 116 CA2d at 126. The court of appeal noted the conflicting evidence on what an inspection would have shown and noted that awareness of the pipeline was not the same as knowledge of the existence of an easement. The court noted that inspection of the pipeline would not have revealed the easement and concluded that the insureds were entitled to rely on the title policy and to assume that the neighbor had a mere license and not an easement.

NOTE: This decision was made when preliminary reports were treated like abstracts of title. Because current preliminary reports by law no longer represent the true status of title, the *Overholtzer* reasoning is unlikely to apply to policies issued after January 1, 1982. See definitions of abstracts and preliminary reports in §§5.25-5.28, 11.38-11.45. The result may be the same as in *Overholtzer*, however, for an insured holding an extended coverage policy such as the ALTA owner's policy (see §7.24), which does not contain this exception.

In *Manneck v Lawyers Title Ins. Corp.* (1994) 28 CA4th 1294, 33 CR2d 771, the insureds obtained a title insurance policy when they purchased their home. Later, when they wanted to rebuild a fence, they ordered a survey and found to their dismay that virtually everything outside their back door, including their pool, deck, and other structures,

encroached on their neighbor's property. After the insurer denied their claim, they sued for breach of contract and bad faith. The trial court held that the insurer had no duty to prosecute an action or indemnify the insureds, and the appellate court affirmed. The court based its decision, in part, on the exclusion in the policy precluding coverage for loss arising from information about the land, which a correct survey would disclose and which was not shown by the public records, and applied the exclusion to the encroachments in question. 28 CA4th at 1302.

In contrast, in *Lagomarsino v San Jose Abstract & Title Ins. Co.* (1960) 178 CA2d 455, 3 CR 80, the title policy described the insured property by courses and distances beginning at two iron pipes on opposite sides of the property, one of which was "in the line of" a railroad company's right of way. After the policy was issued, the railroad conducted its own survey and placed its markers 20 feet inside the insured's survey property line. The insured then contacted the insurer, who told the insured that the railroad right-of-way "monument line" would take precedence over the distances specified in the title policy, which considerably reduced the total area of the property. The insurer argued that it was absolved from liability under its policy on the ground that the right of way is an "ascertained boundary or monument," which prevails over courses and distances, and that the policy guaranteed title only to the land actually bordered by the railroad's right of way. The appellate court rejected that argument, finding both the right of way and the iron pipes to be "monuments." Stating that the title insurer's own description created the ambiguity, the court held that the insurer could not place a selective construction on the description, or an ambiguity in it, to defeat its obligation. 178 CA2d at 1463.

In *Contini v Western Title Ins. Co.* (1974) 40 CA3d 536, 115 CR 257, the court noted:

> It is settled that a standard policy of title insurance is a contract of indemnity which only insures against defects, discrepancies, or other impediments of record affecting the title or interfering with the right of possession of the land described in the policy. The insured is not protected from matters dependent upon a survey or a critical inspection of the property unless the policy provides for extended coverage or the insured requests special endorsements.

PRACTICE TIP: Whether counsel represents the insurer or the insured it is prudent to review carefully all special endorsements that override the standard exclusions. From a defense perspective, the insurer is less likely to be pursued for bad faith; from the plaintiff's point of view, because title policies carry abundant exceptions and exclusions, special endorsements should not be overlooked as the basis for providing coverage.

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§11.84 5. Unpatented Mining Claims and Water Rights

Exception 5 in ALTA and CLTA standard coverage policies (see §11.79) precludes coverage for loss or damage, stating that the insurer will not pay costs, attorney fees, or expenses arising from "(a) [u]npatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims, or title to water, whether or not the matters excepted under (a), (b), or (c) are shown by the public records."

In *Coleman v Security Title Ins. Co.* (1963) 218 CA2d 444, 32 CR 575, the insureds obtained a title policy describing their property as being located in an irrigation district. When they learned that the land was not in the irrigation district, the insureds made a claim under their title policy. The insurer rejected the claim, and the insureds sued. Following a trial court judgment for the insurer, the insureds appealed and the appellate court affirmed. The court noted that there was no defect in the insured's title, and the fact that the policy erroneously referred to the property as being located in the irrigation district did not entitle the insureds to a windfall. See discussion of *Coleman* in §§11.62, 11.72. The court also noted that the policy specifically excluded losses based on "water rights, claims or title to water," and applied this exclusion. 218 CA2d at 445.

In *White v Western Title Ins. Co.* (1985) 40 C3d 870, 221 CR 509, the property in question was subject to an easement for a right of way for the construction and maintenance of wells, a water pipeline, and an easement to carry up to 150 gallons of water per minute from any well in the area. This easement was recorded. When the insureds purchased the property, neither the preliminary title report nor the policy mentioned the recorded easement. The policy contained an exclusion precluding coverage for loss or damage arising from "(a) unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims, or title to water." 40 C3d at 878. Accordingly, the insurer rejected the insureds' damage claim. The trial court entered a judgment in the insureds' favor, and the appellate court affirmed, finding the exclusion to be ambiguous because it did not specifically exclude such recorded interests, and construing it narrowly against the insurer (40 C3d at 881):

> In the present context, these rules [of policy interpretation] require coverage of water rights shown in public records within the scope of an ordinary title search. The structure of the policy itself creates the impression that coverage is provided for claims of record, while excluded for unrecorded claims. This impression is reinforced by the specific language of the policy. Paragraph 3, by excluding easements, liens, and encumbrances "not shown by public records," implies inclusion of such interests when recorded. Paragraph 5, the exclusion of water rights on which Defendant relies, joins that exclusion with exclusion of unpatented mining claims and exceptions in patents or authorizing legislation—interests which would not appear in the records ordinarily searched by a title company.

NOTE: Two important factors put in doubt the application of the reasoning in *White* to policy forms currently being issued. First, the present language of the exception under review excludes mining and water claims whether or not they "are shown by the public records." Second, the newly defined preliminary report is not a representation of the condition of title. See §§11.38-11.45. Counsel are cautioned to compare the language of the policy being analyzed for their client with the policy being interpreted in the cases, the reasoning of which may still apply to older policies. See §11.91.

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§11.85 E. Nonstandard (Typewritten) Coverages, Exclusions, and Exceptions

Despite the widespread use of the standard coverage CLTA policy (see §6.7) and extended coverage ALTA policies (see §§6.8-6.11), some title insurers provide policies that have specially drafted endorsements, exclusions, or exceptions, or that are standardized but less common, such as the ALTA Residential Policy (see §§6.12-6.17). Such policies must be carefully examined. Finding cases that are directly on point as to special typewritten exceptions, or nonstandard or unusual terms, will be difficult. The following cases (see §§11.86-11.87) demonstrate that in interpreting such language, courts use standard rules of policy interpretation and adopt the "plain meaning" of terms whenever possible. For discussion of rules of insurance policy construction and interpretation, see *Montrose Chem. Corp. v Admiral Ins. Co.* (1995) 10 C4th 645, 666, 42 CR2d 324; California Liability Insurance Practice: Claims & Litigation §§3.44-3.65 (Cal CEB 1991).

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§11.86 1. Forced Removal Coverage

In *Manneck v Lawyers Title Ins. Corp.* (1994) 28 CA4th 1294, 33 CR2d 771, the insureds had purchased a home, and title was insured by an ALTA Residential Policy (see App M). The language in the "Covered Title Risks" provided coverage when (28 CA4th at 1298):

> You are forced to remove your existing structure other than a boundary wall or fence because:
> it extends onto adjoining land or onto any easement
> it violates a restriction shown in Schedule B
> it violates an existing zoning law.

When the insureds wanted to replace a fence, they ordered a survey, which revealed that virtually everything beyond their back door, including the swimming pool, deck, and related structures, encroached onto a neighbor's land. When the insurer denied their claim under the policy, they sued the insurer. The trial court entered judgment in the insurer's favor, holding that the encroachments alone did not constitute a defect under the policy. The appellate court affirmed, finding the "forced removal" language to be clear and unambiguous (28 CA4th at 1302):

> The clause in the policy pertaining to forced removal coverage only comes into play if in fact there is a forced removal of the insured's structures which encroach on the property of another.... [T]he insurer could have in good faith waited to act until, for example, a court order requiring removal or the imminent destruction of the encroaching improvements by bulldozers.

PRACTICE TIP: The remark made in the above quoted case, of course, does not excuse an insurer's express contractual duty to defend an action against an insured by a third party seeking to obtain an order or a decree requiring the removal of the encroaching structures. See §§12.34, 12.48-12.51.

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§11.87 2. Exclusion of Government's Claim of Title to Land in Lake Bed

In *Lyon v Western Title Ins. Co.* (1986) 178 CA3d 1191, 224 CR 385, the insured's title was the subject of prior litigation in which a court had ruled that, although the insured owner held title to land between the high and low water mark of Clear Lake, title was subject to a public trust requiring him to restore the land to, and preserve it in, its "natural state." Subsequently, the insured made a claim under his title policy, asserting that the inability to use the property was a compensable title defect. The insured sued after the insurer rejected the claim. The trial court sustained the insurer's demurrer; the insured declined to amend and appealed the ensuing judgment.

The title policy in *Lyon* excluded coverage for any claim to any part of the land "lying within the bed of Clear Lake… under natural conditions." The appellate court concluded that the exclusion applied (178 CA3d at 1203):

> The term 'bed of Clear Lake under natural conditions' *plainly* and *understandably*, we think, refers to the lake bottom under the high water mark. And it appears to have been uniformly so held.

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§11.88 F. Tender of Policy Limits

Condition 6(a)(i) of both the CLTA policy and the 1992 ALTA lender's policy, Condition 6(a) of the 1992 ALTA owner's policy, Condition 7(a)(i) of the 2006 ALTA lender's policy, and Condition 7(a) of the 2006 ALTA owner's policy authorize the insurer to pay the insured the policy limit plus costs, attorney fees, and expenses incurred by the insured and thus to eliminate any further liability under the policy. See §§12.54-12.56. Similarly, Condition 6(a)(ii) of both the CLTA policy and the 1992 ALTA lender's policy and Condition 7(a)(ii) of the 2006 ALTA lender's policy authorize the insurer to purchase an insured lender's indebtedness, plus any costs, attorney fees, and expenses, and thus terminate further liability under the policy. See §12.57. Likewise, Condition 4(a) of the CLTA/ALTA Homeowner's Policies and Condition 4(f) of the 1987 ALTA Residential Policy allow the insurer to terminate its liability by paying policy limits in certain circumstances.

PRACTICE TIP: *Policy Allows Cost/Benefit Choice.* In some cases, the insurer may find that the costs of other available remedies, such as eliminating the defect or prosecuting an action to establish title, may be more than the amount of loss or damage that the insured would suffer. In this situation, the terms cited above permit the insurer to make what is essentially a business decision and choose the less expensive alternative of simply paying the insured for any loss or damage caused by the defect.

NOTE: *Exception If Insured Sued by Third Party.* Although there is no authority on point dealing with title insurance, it is questionable whether a title insurer could tender policy limits to an insured facing litigation, brought by a third party and arising from a defect, and thereby eliminate any duty to defend the insured.

In other types of insurance, depending on the circumstances, insurers are not permitted to terminate their defense obligations by tendering policy limits while litigation against the insured is pending. *Heredia v Farmers Ins. Exch.* (1991) 228 CA3d 1345, 1356, 279 CR 511; *Johnson v Continental Ins. Co.* (1988) 202 CA3d 477, 485, 248 CR 412. The duty to defend is separate from the duty to indemnify. See discussion of title insurers' duty to defend in §§12.27-12.34 and of insurers' options in responding to notice of claim or tender of defense in §§12.47-12.59.

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§11.89 G. Late or Defective Claim Notice

Because a title defect may not become known for years or even decades after the title policy was issued (see §11.91), title policy claims provide fertile ground for arguing that the insured breached the prompt notice requirement in the policy. The claim notice requirements are discussed in more detail in §§12.4-12.12.

Obviously, notice should be provided to the title insurer as soon as any information is received on a defect or loss that the policy may cover. However, if an insured with a title problem reveals that prompt notice was not given to the insurer, the insurer bears the burden of proving that it was prejudiced by the delay if it seeks to deny coverage based on late notice. Standards for establishing such prejudice are discussed in §§12.8-12.10. See also *American Int'l Specialty Lines Ins. Co. v Continental Cas. Ins. Co*. (2006) 142 CA4th 1342, 1366, 49 CR3d 1; *Moe v Transamerica Title Ins. Co.* (1971) 21 CA3d 289, 302, 98 CR 547; *Northwestern Title Sec. Co. v Flack* (1970) 6 CA3d 134, 141, 85 CR 693; 3 Miller & Starr, California Real Estate §7:98 (3d ed 2000).

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§11.90 H. Inadequate Proof of Loss

Condition 5 of the CLTA standard coverage policy and the 1992 ALTA owner's and lender's policies require the insured claimant to submit a sworn proof of loss with every claim. Notably, Condition 4 of the 2006 ALTA owner's and lender's policies removes the requirement that an insured claimant must automatically provide a proof of loss. The insurer must first attempt to determine the amount of loss and, if unable to do so, may then require the insured claimant to furnish a signed (but not sworn) proof of loss.

A title insurer may deny coverage if it is prejudiced by the insured's failure to provide proof of loss or damage or if the insured makes a willful misstatement in a proof of loss. An erroneous statement in a proof of loss may not be sufficient, however, to support a denial of coverage. Likewise, a failure to supply additional information or documentation to support a proof of loss will not support a denial of coverage if the insured provided the best evidence in his or her power at the time. See §§12.20-12.21 for further discussion.

California cases have held that, for a title insurer to deny coverage based on late notice, the insurer must prove actual prejudice, not merely the possibility of prejudice. *Moe v Transamerica Title Ins. Co.* (1971) 21 CA3d 289, 302, 98 CR 547; see §§11.89, 12.23. By analogy, a title insurer should be required to prove actual prejudice before denying a claim based on failure to provide proof of loss.

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§11.91 I. Two-Year Statute of Limitations

An action on a title policy or other title products, such as an abstract, a guaranty, or a certificate of title, must be commenced within 2 years after the insured or aggrieved party discovers the loss or damage. CCP §339(1). See also *Smeaton v Fidelity Nat'l Title* (1999) 72 CA4th 1000, 1002, 85 CR2d 591; *Tabachnick v Ticor Title Ins. Co.* (1994) 24 CA4th 70, 76, 29 CR2d 59; *Contini v Western Title Ins. Co.* (1974) 40 CA3d 536, 547, 115 CR 257. Because of the unique nature of title insurance, a claim may arise years or even decades after the policy was issued. See *Hawkins v Oakland Title Ins. & Guar. Co.* (1958) 165 CA2d 116, 118, 331 P2d 742. Thus, the policy date is generally irrelevant to the limitations issue.

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§11.92 1. Generally Accrues on Date Loss Is Discovered

The statute of limitations begins to run on the date that the insured actually discovers the loss or damage, not the date that the loss or damage could have been discovered with reasonable diligence. *Contini v Western Title Ins. Co.* (1974) 40 CA3d 536, 547, 115 CR 257; *Hansen v Western Title Ins. Co.* (1963) 220 CA2d 531, 538, 33 CR 668. That is not to suggest, however, that reasonable diligence should not be used to discover any loss of damage, because the fact of actual discovery or knowledge may be subject to factual dispute and competing inferences. See *65 Butterfield v Chicago Title Ins. Co.* (1999) 70 CA4th 1047, 1054, 83 CR2d 40; *Contini v Western Title Ins. Co.* (1974) 40 CA3d 536, 547, 115 CR 257. In *65 Butterfield,* the insured argued that the statute of limitations should not accrue until the insured is aware not only of the relevant facts but also that those facts give rise to a claim under the policy. The court noted that, in regard to other types of insurance, knowledge of the underlying facts triggers the limitations period, and knowledge of the potential for coverage is irrelevant. The court, however, did not directly address the issue as it applies to title insurance, finding instead that the evidence demonstrated that the insured had actual knowledge that the claim might be covered.

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§11.93 a. Equitable Tolling

The two-year statute of limitations is equitably tolled while the insurer decides whether to honor or reject a timely filed claim. *Forman v Chicago Title Ins. Co.* (1995) 32 CA4th 998, 999, 38 CR2d 790. The *Forman* court held that the statute does not begin to run until the insurer denies the claim. 32 CA4th at 1006. The equitable tolling doctrine, however, will not restore a claim that is already barred by the statute of limitations. *65 Butterfield v Chicago Title Ins. Co.* (1999) 70 CA4th 1047, 1063, 83 CR2d 40; *CBS Broadcasting, Inc. v Fireman's Fund Ins. Co.* (1999) 70 CA4th 1075, 1085, 83 CR2d 197; *Tabachnick v Ticor Title Ins. Co.* (1994) 24 CA4th 70, 74, 29 CR2d 59; *Bank of America v Allstate Ins. Co.* (CD Cal 1998) 29 F Supp 2d 1129, 1134. Thus, if the insured discovers a title defect and waits more than two years to notify the insurer, the equitable tolling doctrine will not prevent the statute of limitations from running. *Tabachnick v Ticor Title Ins. Co.* (1994) 24 CA4th 70, 77, 29 CR2d 59.

The insured in *65 Butterfield* argued that the doctrine of equitable tolling applied while the insured engaged in informal negotiations with the party making the claim against the title to the insured property. The insured, however, had not notified the insurer of the claim. The court rejected the argument, holding that the doctrine of equitable tolling applies only "where the [insurer] receives notice, *within* the limitation period, of the [insured's] pursuit of the alternative remedy, so that the [insurer] is aware of the need to begin investigating the matter." 70 CA4th at 1063.

The statute may not be tolled, however, while the insurance company reconsiders a claim that it has rejected. *Singh v Allstate Ins. Co.* (1998) 63 CA4th 135, 73 CR2d 546. This claim involved the one-year limitation period required in fire insurance policies under Ins C §2017. In *Albierti v Allstate Ins. Co.* (1999) 74 CA4th 138, 148, 87 CR2d 645, the court held that equitable tolling will continue until the insurer unequivocally denies the claim in writing. See §11.94A for a general cautionary note about using holdings on these policies to interpret other types of policies, particularly on the time within which to bring a claim.

PRACTICE TIP: These holdings emphasize the need to provide prompt notice of any claim, or even a potential claim, to the title insurer.

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§11.93A b. No Accrual Before Delivery of Policy

In *65 Butterfield v Chicago Title Ins. Co.* (1999) 70 CA4th 1047, 83 CR2d 40, the insured argued that the statute of limitations should not accrue before the time the insured receives a copy of the title policy. The court did not decide the issue, however, because a limited partner of the insured testified that lack of a copy of the policy was not the reason for the insured's delay in making a claim under the policy.

In *Smeaton v Fidelity Nat'l Title* (1999) 72 CA4th 1000, 85 CR2d 591, the court did address the issue, holding that a claim founded on a title policy within the meaning of CCP §339(1) "is one which relies upon the language within a written instrument or contract. Accordingly a claim founded upon a title policy does not accrue until the title policy is issued." 72 CA4th at 1004.

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§11.94 c. Contractual Tolling

Policy language may actually suspend or delay the accrual of a cause of action, allowing a reasonable period of time for the insurer to remove the title defect or eliminate the adverse claim against the insured. *Sala v Security Title Ins. & Guar. Co.* (1938) 27 CA2d 693, 704, 81 P2d 578. The policy language in *Sala* provided that (27 CA2d at 699):

> Right of action against the Company shall accrue under this policy (1) when and if, after receiving such notice, it shall fail within a reasonable time, in the name of the Insured, to institute and faithfully prosecute proper action to remove, or otherwise pay, satisfy, compromise or defend to final determination, such adverse claim of title or interest, and (2) when there has been a final determination by a court of competent jurisdiction adverse to the title as insured.

In *65 Butterfield v Chicago Title Ins. Co.* (1999) 70 CA4th 1047, 83 CR2d 40, the insured argued that paragraph 8(b) of the section entitled "Limitation of Liability" of the CLTA Standard Coverage Policy (see App H) prevented the claim against the insurer from accruing until the title defect was resolved adversely to the insured's title through a final judgment. Similar language is found in Condition 8(b) of the 1992 ALTA Loan Policy (App I) and Condition 9(b) of the 2006 ALTA Loan Policy (App J) and the 1992 and 2006 ALTA Owner's Policies (Apps K and L, respectively).

The CLTA policy provision states:

> 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, or if applicable, to the lien of the insured mortgage, as insured.

The court rejected the insured's argument, holding that this policy provision governs the insurer's duty to indemnify and does not apply to when the loss or damage occurs and thus does not apply to when the claim accrues.

For such policies, careful attention must be paid to the insurer's efforts to resolve the dispute because the cause of action will generally accrue and the limitations clock begin to run when the insurer abandons the resolution or fails to resolve the problem within a reasonable time. See §11.94A for additional information on contractual tolling.

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Source: Real Property/California Title Insurance Practice/11 Theories and Defenses in Title Company Actions/§11.94A d. Tolling by Estoppel

§11.94A d. Tolling by Estoppel

Some insurance policies contain clauses imposing private statutes of limitation, typically requiring that a claim be filed within one year after the event causing the loss. See California Liability Insurance Practice: Claims & Litigation §24.20 (Cal CEB 1991). Fire insurance policies in California are required to carry a clause mandating a claim within one year after the inception of the loss. Ins C §2071.

In a case dealing with a claim limitation period imposed by an insurance contract, not by statute, one court has held that an insurer's failure to notify the claimant of the time limits pertaining to the claim may estop the insurer from asserting the contractual time limitations. *Spray, Gould & Bowers v Associated Int'l Ins. Co.* (1999) 71 CA4th 1260, 84 CR2d 552. Although the policy did contain a clause specifying the contractual limitations, the insurer did not give the potential claimant separate or additional notice of the limitation period. Lack of affirmative action does not usually give rise to estoppel but it may when there is an affirmative duty to speak. 71 CA4th at 1268. The court held that 10 Cal Code Regs §2695.4(a), a portion of the Fair Claims Settlement Practices Regulations (10 Cal Code Regs §§2695.1-2695.14), creates such an affirmative duty to speak. This regulation requires that an insurer disclose to first-party claimants or beneficiaries all benefits, coverage, time limits, and other policy provisions that may apply to the insured's claim. The court subsequently dismissed a number of defendant's objections to estoppel. In *SEMX Corp. v Federal Ins. Co.* (SD Cal 2005) 398 F Supp 2d 1103, 1112, a federal district court held the regulations do not require an insurer to provide specific notice of the limitations period when a claim is settled.

Although the regulation involved in *Spray, Gould & Bowers v Associated Int'l Ins. Co., supra,* and in *Neufeld v Balboa Ins. Co.* (2000) 84 CA4th 759, 763, 101 CR2d 151, also applies to title insurers, it is unclear what effect, if any, these cases will have on title insurers because they generally rely on the two-year statutory limitation period of CCP §339(1) and not on contractual periods. But see §11.94. The language of the regulation refers to "time limits or any other provisions *of any insurance policy* issued by the insurer that may apply." [Emphasis added.] Counsel for insurers may argue that, when read literally, the express language of the regulation precludes it from applying to title policies in which the limitations period is established by statute, not by any contract provisions. Counsel for insureds may argue that the *Spray* case should not be followed in title insurance disputes, because, if the public purpose of the regulation is to protect the insured who may not be aware of the limitations period in the contract, that public policy applies even more strongly if the insured would have to consult a statute to learn of the limitations period. Counsel for insureds may also point out that, in holding that the doctrine of equitable tolling applies to title insurance claims (see §11.93), the court in *Forman v Chicago Title Ins. Co.* (1995) 32 CA4th 998, 38 CR2d 790, relied almost exclusively on *Prudential-LMI Commercial Ins. v Superior Court* (1990) 51 C3d 674, 274 CR 387, a case construing contractual limitations periods required in fire policies by Ins C §2071. It remains to be seen which of these arguments the courts will accept in title insurance disputes. Until then, prudent title insurers should consider including a notification of the statutory limitations period in any letter communicating a denial of a claim.

In addition, an insurer may be estopped to assert a limitations period if an insured establishes that its failure to timely file a claim was because the insured reasonably relied on an insurer's misrepresentation of fact that the nature and extent of damage so that it fell below the insured's deductible amount. *Vu v Prudential Prop. & Cas. Ins. Co.* (2001) 26 C4th 1142, 1146, 113 CR2d 70. However, the *Vu* court held that a denial of coverage, phrased as a "representation" that the policy did not cover the claim, will not provide the basis for estoppel.

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§11.95 2. Exception for Duty to Defend—Accrues on Termination Date of Third Party Suit

Considerable case law has developed on the issue of when and in what circumstances causes of action will accrue and the limitations period will run once the insured tenders the defense of a third party claim to the insurer. One case, *Central Bank v Transamerica Title Ins. Co.* (1978) 85 CA3d 859, 149 CR 822, held that the cause of action accrued and the limitations period began when the insured first incurred attorney fees in defending itself in litigation that it claimed the insurer was obligated to defend. Another case, *Israelsky v Title Ins. Co.* (1989) 212 CA3d 611, 261 CR 72, relying on authorities applicable to other types of insurance, held that the cause of action did not accrue while the duty to defend was outstanding, *i.e.*, as long as the underlying third party lawsuit was pending.

The California Supreme Court resolved this conflict in *Lambert v Commonwealth Land Title Ins. Co.* (1991) 53 C3d 1072, 282 CR 445. The court reasoned that the duty to defend, when it exists, continues throughout the pendency of the underlying case and that an anomalous result would occur if the cause of action against the insurer could expire while the underlying action was still pending and the defense duty was unresolved. The *Lambert* court agreed with *Israelsky,* holding that the insured is entitled to wait until the duty to defend expires with the termination of the underlying litigation before being required to commence an action against the insurer for failure to provide a defense.

According to *Lambert*, an insured facing a rejection of a tender of defense may, but need not, immediately commence an action against the insurer. Alternatively, the insured may choose to defend the underlying case at its own expense and prosecute a claim against the insurer after termination of that case. Although *Lambert* does not rule out the possibility of the insurer's filing a declaratory relief action during the pendency of the underlying case, the decision in *Haskel, Inc. v Superior Court* (1995) 33 CA4th 963, 969, 980, 39 CR2d 520, held that the insured could stay in the declaratory relief action all discovery that is "logically related" to the liability issues to be resolved in the underlying proceeding.

WARNING: Counsel should be aware that limitation periods on claims not based on a title policy, guaranty, abstract, or certificate vary in length. Some claims may involve limitation periods as long as four years (*e.g.,* a claim based on an escrow agent's breach of its contractual obligations under written escrow instructions). CCP §337(1). See §11.121. The prudent practitioner will bring all related claims within the two-year period (applicable to policy claims under CCP §339(1)) and claims for negligent and intentional infliction of emotional distress or other personal injury (under CCP §335.1) because many of the miscellaneous tort claims surrounding title insurance disputes are subject to the two-year statute of limitations applicable to claims of liability not based on a written instrument. CCP §339(1).

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Source: Real Property/California Title Insurance Practice/11 Theories and Defenses in Title Company Actions/§11.96 J. Full Credit Bid

§11.96 J. Full Credit Bid

The effect of a full credit bid by an insured lender in a foreclosure proceeding on the lender's subsequent claim of loss under its title insurance policy is the subject of much discussion among practitioners because of decisions such as *Alliance Mortgage Co. v Rothwell* (1995) 10 C4th 1226, 1238, 44 CR2d 352, and *Pacific Inland Bank v Ainsworth* (1995) 41 CA4th 277, 282, 48 CR2d 489. See §11.48. In a nonjudicial foreclosure or trustee's sale, the lender may make a "full credit bid," which is an amount equal to the unpaid principal and interest of the debt being foreclosed on, plus the costs, fees, and other expenses of foreclosure. If the lender buys the property through a full credit bid, the lien on the property is extinguished and the lender may not collect any damages for waste from the debtor or the debtor's successors even if the market value of the property is actually less than the amount of the bid. *Cornelison v Kornbluth* (1975) 15 C3d 590, 606, 125 CR 557. A full credit bid in essence fixes the value of the property between the lender and the borrower. Such a bid also prevents a foreclosing lender from collecting property insurance proceeds for prepurchase damage to the property, on the assumption that it would result in a double recovery for the insured lender. *Alliance Mortgage Co. v Rothwell, supra*; *Cornelison v Kornbluth, supra*.

Under the "full credit bid rule," the market value of the property is considered to be equal to the price obtained at the foreclosure sale. *Cornelison v Kornbluth, supra*. Therefore, a lender who buys the property via a full credit bid cannot complain of being damaged and is precluded from pursuing either the borrower or a third party on tort claims. In *Alliance*, the supreme court carved out a limited exception and allowed a lender who had made a full credit bid to bring an action against a nonborrower third party who fraudulently induced the lender to make the loans. *Alliance Mortgage Co. v Rothwell* (1995) 10 C4th 1226, 1246, 44 CR2d 352.

In *Michelson v Camp* (1999) 72 CA4th 955, 969, 85 CR2d 539, the appellate court held that a lender can pursue a fraud claim against the borrower or a third party if the lender can establish that it was (1) induced to enter into the loan by false representations by the borrower or third party and (2) still under the mistaken belief that the representation was true at the time it made the full credit bid. In *Kolodge v Boyd* (2001) 88 CA4th 349, 365, 105 CR2d 749, the appellate court held that the *Michelson* rule applies not only to fraud claims, but also to negligence and negligent misrepresentation claims. The *Kolodge* court went even further, holding that the full credit bid rule does not apply to any actions that are not on the note, for damages not caused by breach of the loan agreement, from persons who are not borrowers or otherwise party to that agreement or the successor in interest of such a person. 88 CA4th at 366. The *Kolodge* court explained that the full credit bid rule "makes sense" only when applied "for the benefit of the borrower in connection with obligations arising under the note" (88 CA4th at 370) and that "nonborrowers are outside the ambit of the debtor protection policies that justify application of the full credit bid rule (88 CA4th at 371). In *First Commercial Mortgage Co. v Reece* (2001) 89 CA4th 731, 735, 108 CR2d 23, the appellate court held that the full credit bid rule does not apply to a compelled repurchase.

As between an insured lender and a title insurer, however, for the purpose of claims evaluation, the relationship of the foreclosing bid to the indemnifiable loss suffered by the lender has been argued and analyzed differently. See §§11.10-11.14. For example, in *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 275 CR 107, a foreclosing lender who had purchased the security with a $1 credit bid at the trustee sale argued that the proceeds were insufficient to discharge any part of the outstanding balance owed to the lender. 225 CA3d at 425. The appellate court held that "the value of the property in the hands of the foreclosing insured lender is not the measure of loss under the terms of the policy." 225 CA3d at 428.

Similarly, in *Karl v Commonwealth Land Title Ins. Co.* (1993) 20 CA4th 972, 985, 24 CR2d 912 (*Karl I*), and again after remand in *Karl v Commonwealth Land Title Ins. Co.* (1997) 60 CA4th 858, 70 CR2d 374 (*Karl II*), a foreclosing lender made a full credit bid and then argued that its bid fixed the value of the property and that its losses should be calculated as of the foreclosure date. The *Karl* decisions, although they disagree with *Cale* on the date the loss is measured, agree with *Cale* in that a credit bid made by a lender at a foreclosure sale does not establish the property's fair market value for the purpose of calculating the lender's loss on a title insurance claim. 20 CA4th at 985.

As the *Cornelison* rule (*Cornelison v Kornbluth* (1975) 15 C3d 590, 600, 125 CR 557) was ultimately based on public

policy to aid the effectiveness of antideficiency legislation enacted to protect borrowers, a full credit bid is arguably irrelevant to calculating loss relative to an insured lender's claim under a title policy. In both *Cale* and *Karl,* it was the lender, not the insurer, who argued that the bid fixes the value of the property. One might imagine a situation in which an insurer would make that argument to avoid paying policy benefits. Following the *Cornelison* logic, however, leads to the conclusion that the extinguishment of an insured lien vis-à-vis the borrower does not necessarily extinguish the insurer's contractual obligations under a title policy. However, if a lender were to attempt to gain a windfall from title insurance benefits, the full credit bid rule may be raised as a defense. Independently, the formula developed in *Karl v Commonwealth Land Title Ins. Co., supra* (*Karl I*) (see §11.14), would prevent a windfall to the lender at the time of foreclosure. Application of the ruling in *Cale v Transamerica Title Ins. Co., supra* (see §11.13), also prevents a windfall to the insured but allows the insurer to share in the benefits of the property's appreciation after foreclosure to the extent of the insurer's liability under the policy.

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§11.96A K. Less Than Full Credit Bid

In *Track Mortgage Group, Inc. v Crusader Ins. Co.* (2002) 98 CA4th 857, 120 CR2d 228, a lender foreclosed on the insured property and purchased the property under a credit bid of less than the full amount of the debt. The property had been damaged by vandals before the foreclosure. After purchasing the property at the foreclosure, the lender made a claim under the property insurance policy covering the property. The insurer denied the claim, and the lender/purchaser sued for bad faith. The appellate court held that at the time of the loss, the lender's only interest in the property was the repayment of the debt secured by the trust deed. The court further held that the insurer's liability to the lender could never exceed the amount of the secured debt. 98 CA4th at 865. Moreover, the court held that the lender's damages were the difference between its credit bid and the amount of the obligation secured by the trust deed at the time of the foreclosure. 98 CA4th at 866.

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§11.97 L. Rescission—Fraud of Insured

When an insured commits fraud by making false statements or concealing information, and such statements or concealment involve material facts, the insurer may be entitled to rescind the policy. An insurer may raise this affirmative defense in two areas: One involves fraud in the proof of loss required for a claim, which may render the policy void or unenforceable or limit the insurer's liability to the extent of prejudice caused thereby. (This type of fraud is discussed in §12.21.) The second area involves the insured's false statements or concealment in the application for the policy.

EXAMPLES: Applying for a title policy differs significantly from applying for other kinds of insurance. In obtaining a title policy, the applicant often provides no more than the property location and its purchase price. The prospective insurer then conducts its own title examination, using little information from the insured. Misrepresentations may occur, however, in the following ways:

- The insured may report a lower, inaccurate purchase price.
- The insured may fail to reveal other details about the transaction, such as an unrecorded deed of trust, or a "side" payment not handled through the escrow, or a transfer of other property that, on its face, is a separate transaction, but is in fact part of the consideration for purchase of the property.
- The insured may misrepresent or not reveal knowledge about preexisting easements or liens.

Once a claim is made, the insured may attempt to misrepresent or conceal preexisting knowledge of defects or liens.

Although the potential for fraud in both the application and proof-of-loss processes is more prevalent in other forms of insurance (*e.g.,* staged automobile accidents, inflated inventory losses, phony theft claims), an attorney handling a title claim must have a basic understanding of rescission principles.

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§11.98 1. Concealment

The applicable legal principles for concealment in an application for an insurance policy are codified in Ins C §§330-339. "Concealment" means "neglect to communicate that which a party knows and ought to communicate." Ins C §330. The law imposes a good faith disclosure requirement, codified in Ins C §332, requiring each party to an insurance contract to communicate to the other, in good faith, "all facts within his knowledge which are or which he believes to be material to the contract and as to which he makes no warranty, and which the other has not the means of ascertaining."

Insurance Code §334 defines "materiality" of facts concealed during the application for an insurance policy:

> Materiality is to be determined not by the event, but solely by the probable and reasonable influence of the facts upon the party to whom the communication is due, in forming his estimate of the disadvantages of the proposed contract, or in making his inquiries.

This is a subjective test. The critical question is what effect full disclosure would have on the particular insurer, not on an "average reasonable" insurer. *Unionamerica Ins. Co., Ltd. v Fort Miller Group, Inc.* (ND Cal, Mar 16, 2009, No. C05-1912 BZ) 2009 US Dist Lexis 20894; *Imperial Cas. & Indem. Co. v Sogomonian* (1988) 198 CA3d 169, 181, 243 CR 639. Both the information provided by the applicant and information not revealed by the applicant must be viewed for its cumulative impact. 198 CA3d at 181. Materiality may be determined as a matter of law if neither the material facts nor the reasonable inferences to be drawn from them are in dispute. 198 CA3d at 181; *Unionamerica Ins. Co., Ltd. v Fort Miller Group, Inc.* (ND Cal 2008) 590 F Supp 2d 1254, 1259. See also *Burns v Prudential Ins. Co.* (1962) 201 CA2d 868, 20 CR 535.

Generally, a concealment or a misrepresentation is material, either if the insurer, as a careful and intelligent person, would not have issued the policy, or would have issued it at a higher premium, had the truth been known. The absence of fraudulent intent is not significant in determining materiality, because concealment or misrepresentations, even if innocent, are material to the risk when they prevent the insurer from exercising its choice. Assessing the materiality of a fraudulent concealment depends on the nature of the insurance and the risks involved. *Imperial Cas. & Indem. Co. v Sogomonian* (1988) 198 CA3d 169, 179, 243 CR 639 (homeowner's insurance; concealment of previous landslide on property resulted in lawsuit by neighbor). See also *Old Line Life Ins. Co. v Superior Court* (1991) 229 CA3d 1600, 281 CR 15 (life insurance; smoking history); *Pacific Ins. Co. v Kent* (CD Cal 2000) 120 F Supp 2d 1205, 1211 (marine insurance; purchase price of boat). "The fact that the insurer has demanded answers to specific questions in an application for insurance is in itself usually sufficient to establish materiality as a matter of law." *Thompson v Occidental Life Ins. Co.* (1973) 9 C3d 904, 916, 109 CR 473; *Unionamerica Ins. Co., Ltd. v Fort Miller Group, Inc.* (ND Cal 2008) 590 F Supp 2d 1254, 1259.

PRACTICE TIP: Counsel can expect that an insured facing a rescission claim will argue that any misrepresentation was "innocent" or unintentional. Insureds may rely on the *Thompson* rule (*Thompson v Occidental Life Ins. Co.* (1973) 9 C3d 904, 109 CR 473), under which an insurer has no ground to rescind an insured's policy if the applicant either had no knowledge of certain medical information or did not understand its significance at the time the application was made. 9 C3d at 916.

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§11.99 2. Misrepresentation

Insurance Code §§350-361 govern misrepresentations made in applications for insurance policies. Under Ins C §350, a representation may be oral or written and may be made at the time of or before the policy is issued. Under Ins C §358, a representation is false when the facts conflict with its assertions or stipulations. Under Ins C §360, the materiality of a representation "is determined by the same rule as the materiality of a concealment." See §11.98.

Insurance Code §359 permits rescission based on a material misrepresentation. In *Barrera v State Farm Mut. Auto. Ins. Co.* (1969) 71 C2d 659, 666, 79 CR 106, an applicant denied having a prior suspension of his driver's license. The supreme court observed that an insurer may rescind an insurance contract ab initio for a material misrepresentation even if the insured's misstatements were the result of negligence or innocence. 71 C2d at 665 n4; *Unionamerica Ins. Co., Ltd. v Fort Miller Group, Inc.* (ND Cal Mar 16, 2009, No. C05-1912 BZ) 2009 US Dist Lexis 20894. The insurer need not prove that the insured intended to deceive. *Thompson v Occidental Life Ins. Co.* (1973) 9 C3d 904, 915, 109 CR 473. See also *Lunardi v Great-West Life Assur. Co.* (1995) 37 CA4th 807, 821, 44 CR2d 56. Indeed, in *Pacific Ins. Co. v Kent* (CD Cal 2000) 120 F Supp 2d 1205, 1210, the court held that the applicant for insurance was bound by misrepresentations in an application filled out by the insurer's agent, even if the applicant chose to not read it.

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§11.100 3. Warranties

An injured insurer may rescind an insurance policy based on a violation of a material warranty or other material policy provision. Ins C §447. The policy itself must contain an express warranty. Ins C §443. Curiously, the Code does not define "implied warranty," although "express warranty" is defined as a "statement in a policy of a matter relating to the person or thing insured, or to the risk, as a fact." Ins C §441. Extrapolating from this definition, an implied warranty may be defined as a statement, not in a policy, relating to the person or thing insured, or to the risk, as a fact. No specific wording is necessary to create a warranty. Ins C §442. Further, under Ins C §444, a warranty may relate to the past, the present, the future, or all three.

Materiality of a warranty is generally governed by the same rules as those for materiality of concealment or misrepresentation. See §11.98. Under Ins C §449, a breach of warranty without fraud merely exonerates the insurer from the time the breach occurs, but if the warranty is broken at the inception of the policy, the policy is void ab initio.

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§11.101 4. Consequences of Rescission

Although breach of warranty without fraud exonerates an insurer from the time it occurs (Ins C §449), rescission of a policy generally voids it ab initio, *i.e.,* the policy was totally unenforceable from the outset—coverage never existed and no benefits were due to the insured. *Imperial Cas. & Indem. Co. v Sogomonian* (1988) 198 CA3d 169, 182, 243 CR 639. Once a policy is rescinded, an insurance contract is deemed never to have existed and the parties never had an "insured" and "insurer" relationship. 198 CA3d at 184.

Unless the policy provides otherwise, rescission bars benefits to all additional insureds or beneficiaries under the policy. Ins C §650. But if the fraud, concealment, or misrepresentation asserted as a ground for rescission relates solely to coverage for an additional insured, those issues may be severable and the insurer may rescind coverage for the additional insured without rescinding it for the named insured. See, *e.g.*, *Merced County Mut. Fire Ins. Co. v State* (1991) 233 CA3d 765, 775, 284 CR 680.

Rescission is not the exclusive remedy for misstatements or omissions in an insurance application. The insurer may assert such misstatements or omissions as a defense to the claim, as a ground for recovery of benefits paid, or as a ground for reformation of the policy to exclude coverage for the disputed matters. *Williamson & Vollmer Eng'g v Sequoia Ins. Co.* (1976) 64 CA3d 261, 275, 134 CR 427.

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§11.102 M. Mechanics' Liens Defenses

Although there is no express exclusion for unrecorded mechanics' liens in the CLTA policy or the ALTA owner's policy, these policies generally do not insure against such liens. In the ALTA lender's policies, mechanics' lien coverage is provided (see §6.30) and may be augmented by purchasing special endorsements (see §§8.83-8.84). This coverage may become an issue when a policy is issued after work has begun on an improvement to the insured property. In this situation, counsel for both the insurer and insured should keep in mind that although the mechanics' lien need not be recorded until after the project is finished, the priority date for the lien relates back to the date work on the project was begun. Thus, until the work is done, the contractor has a potential unrecorded lien that will not be insured under these standard policies unless a special endorsement is added. See §11.55.

Other than ascertaining whether the policy covers mechanics' liens, the insurer will be required to appoint counsel if coverage applies to a third party claim. Defenses to such actions are based on statutory prerequisites to enforcement, failure to join necessary parties, and other factors. For a comprehensive discussion of enforcing mechanics' liens, see California Mechanics' Liens and Related Construction Remedies, chap 3 (3d ed Cal CEB 1998) (foreclosure processes for private works); Mechanics' Liens, chap 4 (foreclosure processes for public works); and Handling Mechanics' Liens and Related Remedies (Private Works) (Cal CEB Action Guide October 2008). On a title company's role in insuring mechanics' lien losses, see §§7.88-7.89.

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VIII. DEFENSES TO BAD FAITH AND PUNITIVE DAMAGES

A. Bad Faith Affirmative Defenses

§11.103 1. Advice of Counsel

Technically, advice of counsel is only a partial affirmative defense. If proved, it will not necessarily eliminate all liability on the part of the insurer. See also *Stewart v Truck Ins. Exch.* (1993) 17 CA4th 468, 483, 21 CR2d 338. However, the fact that the insurer reasonably relied on advice from competent counsel is a factor that, if accepted by the trier of fact, usually precludes a finding of bad faith or malice, fraud, or oppression. *State Farm Mut. Auto. Ins. Co. v Superior Court* (1991) 228 CA3d 721, 725, 279 CR 116.

To successfully defend using the advice of counsel defense, the insurer must prove that (a) it fully disclosed the facts to the attorney in requesting the advice, or the attorney initiated the advice based on familiarity with the case; (b) the insurer relied on the attorney's advice in good faith; and (c) it acted on the attorney's advice. See, *e.g.*, *Melorich Builders, Inc. v Superior Court* (1984) 160 CA3d 931, 936, 207 CR 47; *Merritt v Reserve Ins. Co.* (1973) 34 CA3d 858, 872, 110 CR 511.

Asserting the defense of advice of counsel does not automatically waive all communications between the insurer and the insurer's coverage counsel. This defense may be narrowly tailored and asserted on one or more particular issues. For example, in *Transamerica Title Ins. Co. v Superior Court* (1987) 188 CA3d 1047, 1050, 233 CR 825, the insurer limited its advice of counsel defense to the single issue of the reason for its initial filing of a declaratory relief action, and did not assert it on its refusal to pay policy benefits. The court noted that implied waivers of privilege are to be narrowly construed and that information discoverable as a result of the waiver must fit strictly within the confines of the waiver. 188 CA3d at 1052. The court concluded that asserting this defense, on the sole issue of the reason for initially filing the declaratory relief action, did not waive the attorney-client privilege for other advice that counsel gave the insurer in deciding whether to deny coverage or defend the case. 188 CA3d at 1053.

Although advice of counsel is not strictly an affirmative defense and thus need not be pleaded in the answer, there is nothing unfair about allowing the insurer to introduce evidence of advice of counsel as a defense at trial, even when that defense was not pleaded in the answer, if the insured did not propound discovery to learn whether the insurer would rely on that defense. *State Farm Mut. Auto. Ins. Co. v Superior Court* (1991) 228 CA3d 721, 727, 279 CR 116.

PRACTICE TIP: Counsel for the insured should propound discovery early in any dispute to learn whether the insurer intends to assert the advice of counsel defense, and, if so, to require the insurer to identify each issue on which the defense will be raised. Asserting the defense will result in at least a partial waiver of the attorney-client privilege between the insurer and coverage counsel; therefore, the insurer's counsel should consider whether to assert a blanket advice of counsel defense on all issues or a more limited defense based on advice given on one or more specific issues.

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§11.103A 2. Genuine Dispute Doctrine

The genuine dispute doctrine arises because of the difference between the proof required to establish breach of the insurance contract and the proof necessary to establish breach of the implied covenant of good faith. Without more, a denial of policy benefits is merely a breach of contract. To establish bad faith, the plaintiff must prove that the insurer's conduct was unreasonable or without proper cause. Bad faith implies unfair dealing rather than mistaken judgment. *Chateau Chamberay Homeowners Ass'n v Associated Int'l Ins. Co.* (2001) 90 CA4th 335, 345, 108 CR2d 776; *Congleton v National Union Fire Ins. Co.* (1987) 189 CA3d 51, 59, 234 CR 218. The mistaken or erroneous withholding of policy benefits, if reasonable or if based on a genuine dispute as to the insurer's liability, does not expose the insurer to a bad faith claim. *McCoy v Progressive W. Ins. Co.* (2009) 171 CA4th 785, 793, 90 CR3d 74; *Century Sur. Co. v Polisso* (2006) 139 CA4th 922, 949, 43 CR3d 468; *Chateau Chamberay Homeowners Ass'n v Associated Int'l Ins. Co.* (2001) 90 CA4th 335, 346, 108 CR2d 776; *Nager v Allstate Ins. Co.* (2000) 83 CA4th 284, 288, 99 CR2d 348; *Fraley v Allstate Ins. Co.* (2000) 81 CA4th 1282, 1292, 97 CR2d 386. Likewise, sloppy or negligent claims handling does not reach the level of bad faith. *Chateau Chamberay Homeowners Ass'n v Associated Int'l Ins. Co.* (2001) 90 CA4th 335, 351, 108 CR2d 776.

The genuine dispute doctrine is very likely not a "new matter" that must be pleaded as an affirmative defense. In fact, the plaintiff in a bad faith case bears the burden of proof to establish that the insurer's conduct was unreasonable or without proper cause. *Gourley v State Farm Mut. Auto. Ins. Co.* (1991) 53 C3d 121, 127, 3 CR2d 666; *Chateau Chamberay Homeowners Ass'n v Associated Int'l Ins. Co.* (2001) 90 CA4th 335, 108 CR2d 776; *Dalrymple v United Servs. Auto. Ass'n* (1995) 40 CA4th 497, 520, 46 CR2d 845. Thus, establishing the lack of a genuine dispute over the insurer's liability under the policy should simply be part of the plaintiff's burden of proof.

State and federal courts applying California law have applied the genuine dispute doctrine to legal disputes over policy language or its application. *Filippo Indus. v Sun Ins. Co.* (1999) 74 CA4th 1429, 88 CR2d 881; *Dalrymple v United Servs. Auto. Ass'n* (1995) 40 CA4th 497, 46 CR2d 845; *Tomaselli v Transamerica Ins. Co.* (1994) 25 CA4th 1269, 31 CR2d 433; *Safeco Ins. Co. v Guyton* (9th Cir 1982) 692 F2d 551, 557.

More recently, courts applying California law have applied the genuine dispute doctrine to factual disputes. For example, in *Fraley v Allstate Ins. Co.* (2000) 81 CA4th 1282, 1292, 97 CR2d 386, a fire damaged the insureds' home. The insureds and their insurer obtained vastly different estimates from contractors and could not agree on the scope and cost of repairs. After the parties submitted the valuation issue to an arbitrator, the insureds sued for bad faith, accusing the insurer of "low balling" and hiring "captive" contractors. The *Fraley* court held that the genuine dispute doctrine may be applied when the insurer denies a claim based on the opinions of experts. The court explained, "[w]here the parties rely upon expert opinions, even a substantial disparity in estimates for the scope and cost of repairs does not, by itself, suggest the insurer acted in bad faith." 81 CA4th at 1293. Based on the existence of a genuine dispute over the insurer's contractual obligations, the *Fraley* court affirmed summary judgment in the insurer's favor as to the bad faith cause of action. "It is now settled law in California that an insurer denying or delaying the payment of policy benefits due to the existence of a genuine dispute with its insured as to the existence of coverage liability or the amount of the insured's coverage claim is not liable in bad faith even though it might be liable for breach of contract." *Chateau Chamberay Homeowners Ass'n v Associated Int'l Ins. Co.* (2001) 90 CA4th 335, 347, 108 CR2d 776. See also *Guebara v Allstate Ins. Co.* (9th Cir 2001) 237 F3d 987, 993.

However, the insurer's reliance on expert opinions does not automatically establish the existence of a genuine dispute. Although the precise parameters of the genuine dispute doctrine await further judicial clarification (as well as supreme court approval), the courts have suggested that the doctrine will not apply in the following situations:

- The insurer is guilty of misrepresenting the nature of the investigatory proceedings, *e.g.,* misleading the insured as to the nature of an examination under oath;
- The insurer's employees lie during the depositions or to the insured;
- The insurer dishonestly selects its experts;
- The insurer's experts are unreasonable; or

- The insurer fails to conduct a thorough investigation.

C*hateau Chamberay Homeowners Ass'n v Associated Int'l Ins. Co.* (2001) 90 CA4th 335, 348, 108 CR2d 776, citing with approval *Guebara v Allstate Ins. Co., supra*.

In *McCoy v Progressive W. Ins. Co.* (2009) 171 CA4th 785, 90 CR3d 74, the insurer proposed a jury instruction based on the foregoing factors, and another that stated (171 CA4th at 792):

> When an insurer denies or delays payment of policy benefits due to the existence of a genuine dispute with its insured as to the existence of coverage liability, the insurance company will not be liable in bad faith even though it may be liable for breach of contract.

The trial court refused to give either instruction, and the appellate court affirmed, holding that the genuine dispute doctrine is subsumed within the concept of what is reasonable and unreasonable as set forth in CACI 2331 and 2332, and that "[n]o further instruction in this regard was necessary." 171 CA4th at 794. CACI 2331, "Essential Factual Elements," instructs a jury that to establish bad faith failure to pay or delay in paying benefits due under the insurance policy, the plaintiff must prove, "That [name of defendant], unreasonably or without proper cause, [failed to pay/delayed payment of] policy benefits." CACI 2332, "Failure to Properly Investigate Claim," instructs the jury:

> [Name of defendant] acted unreasonably or without proper cause if it failed to conduct a full, fair, and thorough investigation of all of the bases of the claim. When investigating [name of plaintiff]'s claim, [name of defendant] had a duty to diligently search for and consider evidence that supported coverage of the claimed loss.

NOTE: "Advice of counsel" is frequently asserted as an affirmative defense in bad faith cases. However, case law recognizes that the "advice of counsel" defense is not a true affirmative defense, but rather negates an essential element of the insured's cause of action for bad faith. *State Farm Mut. Auto. Ins. Co. v Superior Court* (1991) 228 CA3d 721, 725, 279 CR 116. Nevertheless, there is a specific CACI instruction, CACI 2335, which states that defendant "did not breach the obligation of good faith and fair dealing if it reasonably relied on the advice of its lawyer," and sets forth five elements to determine if the defendant reasonably relied on the attorney's advice. An argument can be made that, like the "advice of counsel" defense, applicable elements of the "genuine issue doctrine" deserve a special instruction to the jury.

Whether the insurer "dishonestly selects its experts" or whether the insurer's experts are "unreasonable" may very often involve factual disputes of their own, thereby precluding the applicability of the genuine dispute doctrine. However, in *Chateau Chamberay Homeowners Ass'n v Associated Int'l Ins. Co.* (2001) 90 CA4th 335, 349, 108 CR2d 776, the court held that the insured's expert's "conclusionary opinions" were insufficient to raise a triable issue of material fact to defeat an insurer's summary judgment motion based on the genuine dispute doctrine.

PRACTICE TIP: Attorneys representing insureds in bad faith disputes involving the calculation of damages by experts should consider conducting discovery on how the insurer selected its expert, and the relationship of the insurer and the expert. Such evidence may be necessary to raise a factual dispute if the insurer moves for summary judgment based on the genuine dispute doctrine.

In *Century Sur. Co. v Polisso* (2006) 139 CA4th 922, 951, 43 CR3d 468, the court noted it could not find any case that applied the genuine dispute doctrine to the duty to defend. The duty to defend is broader than the duty to indemnify, and any doubt as to whether the facts establish a duty to defend must be resolved in favor of the insured. See §§12.28-12.34.

NOTE: While the genuine dispute doctrine may apply to a duty to defend, because a duty to defend exists when there is a potential for coverage, the genuine dispute would more likely be one concerning the interpretation or application of policy language than one concerning the underlying facts.

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§11.104 3. Insured's Breach of Contract

The insurer's duty of good faith is unconditional and independent of the insured's performance of its contractual duties. *Gruenberg v Aetna Ins. Co.* (1973) 9 C3d 566, 578, 108 CR 480. Therefore, in a bad faith case, the insured's breach of contract may not be used by the insurer as a complete defense. The insured's breach may provide a partial defense, however, by establishing that the insurer's conduct was not "unreasonable" or "without proper cause," and thus was not in bad faith. For example, in *California Cas. Gen. Ins. Co. v Superior Court* (1985) 173 CA3d 274, 282, 218 CR 817 (disapproved on other grounds in *Kransco v American Empire Surplus Lines Ins. Co.* (2000) 23 C4th 390, 407, 97 CR2d 151), the court held that the conduct of the insured's counsel during the processing of the claim would be admissible on the issue of whether the insurer unreasonably delayed in investigating and paying the claim. And in *California Shoppers, Inc. v Royal Globe Ins. Co.* (1985) 175 CA3d 1, 46, 221 CR 171, the insured's conduct in sending a summons and complaint to the insurer in an envelope bearing the name of a different corporate entity (which was insured by the same insurer but under a different policy), and with no cover letter or other explanation, precluded a finding that the insurer had refused to defend in bad faith.

Even a denial of a claim or refusal to defend based on the insured's lack of cooperation, or inadequate or untimely notice of claim or proof of loss, cannot be justified unless the insurer was substantially prejudiced by the insured's conduct. See §§12.8-12.10, 12.23, 12.44-12.46.

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§11.105 4. Comparative Bad Faith Affirmative Defense Abolished

The leading case permitting an insurer to assert the insured's comparative bad faith or the insured's counsel to reduce the damages claimed by the insured was *California Cas. Gen. Ins. Co. v Superior Court* (1985) 173 CA3d 274, 280, 218 CR 817. However, in *Kransco v American Empire Surplus Lines Ins. Co.* (2000) 23 C4th 390, 97 CR2d 151, the California Supreme Court expressly disapproved of the holding in *California Cas.* (23 C4th at 407), holding that an insurer that breaches the covenant of good faith and fair dealing by failing to settle a third party action within policy limits when there is a substantial risk of an excess judgment may not assert a defense of comparative bad faith. The insurer may not later fault the insured's litigation misconduct for contributing to the amount of the verdict in excess of the policy limits. 23 C4th at 401. The *Kransco* court reasoned that the insured's breach of the implied covenant of good faith and fair dealing was a breach of contract, but not a tort, and hence does not give rise to tort damages. The court further reasoned that the insurer's duty of good faith is unconditional and independent of the performance of the insured's contractual obligations. The court concluded that, because the insured's breach of the covenant does not sound in tort, the insured's contractual breach of an express policy provision cannot be raised by the insurer as a defense in a bad faith action brought against it by the insured. Therefore, no instructions should be given to the jury on the principles of comparative bad faith. 23 C4th at 408.

The court noted, however, that the rejection of comparative bad faith does not leave the insurer without remedies for an insured's bad faith. The insured's bad faith may be used for the following purposes:

- To factually disprove the insurer's liability for bad faith by showing that the insurer acted reasonably in the circumstances;
- To establish breach of conditions precedent to coverage under the policy, such as breach of the insured's duty of cooperation; and
- To support a separately actionable contract claim.

Some forms of misconduct by an insured, *e.g.,* fraud or misrepresentation, will void coverage altogether under the policy. Fraudulent conduct by the insured may be separately actionable.

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§11.105A 5. Comparative Negligence

To the extent that the insured's own negligence caused the loss, comparative negligence may reduce the amount of damages the insured may recover. For example, in *Patrick v Maryland Cas. Co.* (1990) 217 CA3d 1566, 1570, 267 CR 24, the insured made a claim for damage to his roof. When the roof was not repaired promptly, he decided to repair it himself. During the repair effort, he fell and was injured. The court held that to the extent the insured's damages were caused by his own negligence, comparative negligence would reduce his recoverable damages. But see *Travelers Ins. Co. v Lesher* (1986) 187 CA3d 169, 194, 231 CR 791, disapproved on other grounds in *Buss v Superior Court* (1997) 16 C4th 35, 50 n12, 52 n14, 65 CR2d 366 (insured's negligence not permitted to offset insurer's liability for bad faith).

The supreme court in *Kransco v American Empire Surplus Lines Ins. Co.* (2000) 23 C4th 390, 411, 97 CR2d 151, distinguished *Patrick v Maryland* as a first party case, and held that comparative negligence cannot be applied to shield an insurer from full responsibility for its bad faith failure to settle a case—a third party claim—even if the insured's litigation misconduct or mishandling of the claim inflated the size of the underlying verdict against the insured. Notably, the court declined to decide whether comparative fault may be asserted by an insurer in a first party case. The court did, however, note that evidence of the insured's misconduct in a first party case may support contract defenses, cross-claims, or separate causes of action, just as in a third party claim.

NOTE: The supreme court in *Kransco* noted that the insured's negligent acts in *Patrick v Maryland* [walking backwards on a roof while dragging a heavy sheet of plywood] were "outside the contractual relationship of the parties" and occurred after the insurer's bad faith failure to pay the claim. The court pointed out that the insurer in *Patrick* had no duty to protect its insured when the insured decided to make his own roof repairs. Thus, the court seems to imply that a comparative negligence defense may have to be based on the insured's conduct unrelated to the insured's duties under the contract.

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§11.105B 6. No Reverse Bad Faith Cause of Action

In *Agricultural Ins. Co. v Superior Court* (1999) 70 CA4th 385, 82 CR2d 594, the insurer cross-complained against its insured, alleging reverse bad faith," *i.e.,* the insured's tortious breach of the implied covenant of good faith and fair dealing. The insured demurred to the reverse bad faith cause of action. The trial court sustained the demurrer without leave to amend. The appellate court affirmed, holding that an insurer has no claim against its insured in tort for breach of the covenant of good faith and fair dealing.

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§11.105C 7. Fraud Cross-Complaint

In *Agricultural Ins. Co. v Superior Court* (1999) 70 CA4th 385, 82 CR2d 594, the insurer cross-complained against its insured, alleging fraud, among other things. The court held that a demurrer to the fraud cause of action should have been overruled. The court explained that, although an insured does not bear the type of obligations that can give rise to a claim for tortious breach of the covenant of good faith, an insured—no different from everyone else—has a duty not to defraud: First, an insured must not defraud in obtaining the policy. Second, an insured must not defraud in making a claim on the policy. When an insured makes a claim to its insurer, it triggers the insurer's duty to investigate. If, because of the insured's false factual assertions, the insurer incurs expenses that would otherwise not have been necessary, the insurer can plead justifiable detrimental reliance. Although a mere inflated opinion of a claim's value is not fraud, deliberately false factual assertions can be fraud.

NOTE: The supreme court in *Kransco v American Empire Surplus Lines Ins. Co.* (2000) 23 C4th 390, 97 CR2d 151, expressly approved this holding from *Agricultural Ins. Co. v Superior Court, supra*.

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§11.106 8. Settlement and Release

On rare occasions, an insured settles a claim on the policy and, although having signed a general release, then tries to sue the insurer for bad faith. The general release, however, bars a subsequent bad faith claim. The release is an affirmative defense that must be specially pleaded. *Stanton v Santa Ana Sugar Co.* (1927) 84 CA 206, 208, 257 P 907.

To escape the binding effect of a general release, the insured must show that he or she did not agree to its terms, which often requires proof that the insured was under a mental or physical disability and that the insurer committed misconduct that constituted overreaching. For discussion of cases in which the insurer's overreaching invalidated the release, see *Edwards v Comstock Ins. Co.* (1988) 205 CA3d 1164, 1168, 252 CR 807.

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§11.107 B. Defenses to Punitive Damages Claims

Obviously, the best defense to a punitive damages claim is to demonstrate that the insured was owed no benefits under the policy. Short of that, there are no true affirmative defenses to such a claim. However, proving punitive damages does involve unique issues that may provide fertile ground for the defense. Examples of cases in which punitive damages were denied are given in §11.37.

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§11.108 1. No Advance Knowledge, Conscious Disregard, Authorization, or Ratification

Rarely, if ever, will a claim for punitive damages in an insurance contract be based on a claim that an employee of the insurer was unfit. But when such a claim is raised, CC §3294(b) provides that the employer shall not be held liable for punitive damages based on an employee's acts "unless the employer had advance knowledge of the unfitness of the employee and employed him or her with a conscious disregard of the rights or safety of others or authorized or ratified the wrongful conduct" for which the damages are sought. In *Hale v Farmers Ins. Exch.* (1974) 42 CA3d 681, 692, 117 CR 146, disapproved on other grounds in *Egan v Mutual of Omaha Ins. Co.* (1979) 24 C3d 809, 822 n5, 169 CR 691, the court found sufficient evidence that the company authorized or ratified the acts of a claims supervisor who, following normal procedure, exercised discretion in handling the claim and sent the claim file to the regional office. See also *Weeks v Baker & McKenzie* (1998) 63 CA4th 1128, 1148, 74 CR2d 510.

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§11.109 2. No Involvement of Officer, Director, or Manager of Corporation

Under CC §3294(b), before a corporate employer may be held liable for punitive damages based on the acts of an employee, the plaintiff must prove that the advance knowledge and conscious disregard, authorization, ratification, or act of oppression, fraud, or malice is attributable to "an officer, director, or managing agent of the corporation." Although there is no precise definition of who qualifies as a managing agent, it is clear that the person's title is not dispositive. For example, in *Egan v Mutual of Omaha Ins. Co.* (1979) 24 C3d 809, 823, 169 CR 691, a claims agent with broad discretion to handle claims with little if any supervision was held to be a managerial employee. See also *White v Ultramar, Inc.* (1999) 21 C4th 563, 571, 88 CR2d 19 (managers were "managing agents" who were vested with a degree of discretion over decisions that would ultimately set corporate policy).

Even if the employee is deemed a managing agent, it is unlikely that the employer will be held liable for punitive damages if the employee's conduct was outside the course and scope of employment. See *College Hosp. v Superior Court* (1994) 8 C4th 704, 724, 34 CR2d 898 (hospital employee not involved in patient's treatment had affair with patient).

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§11.110 3. Lack of "Clear and Convincing" Proof

Before punitive damages may be awarded, at least in certain instances specified by statute, CC §3294(a) requires proof "by clear and convincing evidence" that the defendant is guilty of oppression, fraud, or malice. See §11.35A. Counsel representing insurers should emphasize that clear and convincing proof is the highest evidentiary standard applicable in civil actions. Clear and convincing evidence means evidence demonstrating a strong probability that the alleged facts actually occurred. *Mock v Michigan Millers Mut. Ins. Co.* (1992) 4 CA4th 306, 332, 5 CR2d 594. This standard is defined in CACI 201: "This means the party must persuade you that it is highly probable that the fact is true." See *Mattco Forge, Inc. v Arthur Young & Co.* (1997) 52 CA4th 820, 60 CR2d 780, regarding former BAJI 2.62, the predecessor to CACI 201.

In *Basich v Allstate Ins. Co.* (2001) 87 CA4th 1112, 1119, 105 CR2d 153, the appellate court held that when the plaintiff's ultimate burden of proof was by "clear and convincing" evidence, that higher standard of proof must be taken into account in ruling on a summary judgment motion. Specifically, the court held that the clear and convincing evidence standard applies to a motion for summary adjudication with respect to a punitive damages claim.

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§11.111 4. Lack of Proof of Insurer's Financial Condition

Evidence of the defendant's financial condition is a prerequisite to an award of punitive damages, and the plaintiff has the burden of producing that proof. *Adams v Murakami* (1991) 54 C3d 105, 110, 284 CR 318; *Tomaselli v Transamerica Ins. Co.* (1994) 25 CA4th 1269, 1282, 31 CR2d 433. A consolidated financial statement of the insurer and other parent companies or subsidiary companies may not be sufficient. 25 CA4th at 1283.

PRACTICE TIP: The insured's burden of producing evidence of the insurer's financial condition can cause fierce discovery battles. The insured will contend that it has the right to conduct such discovery because it has the burden of proof on this issue. The insurer will often resist, being unwilling to release confidential or sensitive information about its financial position. Thus the insurer's counsel should seek bifurcation of the punitive damage phase of the trial as well as a stipulation from the insured's counsel that the insurer will make financial information available, but that it be kept under seal by the insurer's counsel until such time as the jury returns a finding of malicious, oppressive, or fraudulent conduct. See §13.21 for discovery issues related to punitive damages.

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IX. DEFENSES TO OTHER TORT CLAIMS

§11.112 A. Introduction

Sections 11.113-11.122 discuss commonly used defenses that might be asserted by a title company. The specific facts of a given case will establish what theories and what defenses may be raised. The following list is not exhaustive. For further discussion of tort defenses that might arise in an insurance dispute, see California Liability Insurance Practice: Claims & Litigation, chap 28 (Cal CEB 1991).

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B. Slander of Title

§11.113 1. Falsity Required

Falsity is an essential element of a cause of action for slander of title. *Gudger v Manton* (1943) 21 C2d 537, 541, 134 P2d 217, disapproved on other grounds in *Albertson v Raboff* (1956) 46 C2d 375, 381, 295 P2d 405. True statements about title to the property are not disparaging and are justified. *Kirsch v Barnes* (ND Cal 1957) 153 F Supp 260, 264, aff'd (9th Cir 1959) 263 F2d 692; *Gudger v Manton, supra*.

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§11.114 2. Absolute Privilege for Judicial Proceedings

Civil Code §47(b) provides an absolute privilege against claims of slander or libel for publications made in any judicial proceeding. This privilege precludes any claim of slander of title based on a publication either required or permitted by law in the course of a judicial proceeding to achieve the objects of litigation. *Albertson v Raboff* (1956) 46 C2d 375, 380, 295 P2d 405; *Frank Pisano & Assoc. v Taggart* (1972) 29 CA3d 1, 24, 105 CR 414. The privilege also applies to statements made in connection with private, contractual arbitrations. *Moore v Conliffe* (1994) 7 C4th 634, 647, 29 CR2d 152. The privilege has been applied to the recording of both an assessment lien by a condominium homeowners' association and a notice of lis pendens based on a properly filed lawsuit. CC §47(b)(4); *Wilton v Mountain Wood Homeowners Ass'n* (1993) 18 CA4th 565, 824 n1, 22 CR2d 471. It has also been applied to the filing of a claim of a mechanics' lien in conjunction with judicial proceedings. *Frank Pisano & Assoc. v Taggart* (1972) 29 CA3d 1, 25, 105 CR 414.

The absolute privilege of CC §47(b) does not apply, however, to the recording of a lis pendens unless the underlying action properly alleges a real property claim. In *Palmer v Zaklama* (2003) 109 CA4th 1367, 1380, 1 CR3d 116, the court held that the defendants' appeal of a collection action against them was not an appropriate action for recordation of a lis pendens because it was a slander of title action for money damages.

Normally, the defendant bears the burden of pleading and proving the privilege, but if an absolute privilege appears on the face of the plaintiff's complaint, it may be subject to a demurrer. *Smith v Commonwealth Land Title Ins. Co.* (1986) 177 CA3d 625, 630, 223 CR 339.

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§11.115 3. Conditional Privilege of Rival Claimant

Civil Code §47(c) creates a conditional privilege against a claim of slander or libel regarding a communication, made without malice, to an interested person by (a) one who is also interested, (b) one who stands in such a relation to the person interested as to afford a reasonable ground for supposing the motive for the communication to be innocent, or (c) one who is requested by the interested person to reveal the information. Section 47(c) has been held to create a conditional privilege for statements made by a rival claimant to real property as long as the statement was made without malice. *Gudger v Manton* (1943) 21 C2d 537, 545, 134 P2d 217, disapproved on other grounds in *Albertson v Raboff* (1956) 46 C2d 375, 381, 295 P2d 405; *Hill v Allan* (1968) 259 CA2d 470, 490, 66 CR 676.

Although the defendant normally bears the burden of pleading and proving the conditional privilege as an affirmative defense, if the privilege appears on the face of the plaintiff's complaint, the plaintiff has the burden of pleading malice sufficient to overcome the privilege. *Smith v Commonwealth Land Title Ins. Co.* (1986) 177 CA3d 625, 630, 223 CR 339. If the complaint discloses the conditional privilege and does not allege malice, the defendant may demur. 177 CA3d at 630.

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§11.116 4. Statute of Limitations: Equitable Tolling

The statute of limitations for a cause of action for slander of title is three years. CCP §338(g); *Howard v Hudson* (9th Cir 1958) 259 F2d 29, 31. See also *Stalberg v Western Title Ins. Co.* (1994) 27 CA4th 925, 929, 32 CR2d 750. However, the statute of limitations does not begin to run until the plaintiff could reasonably be expected to discover the existence of the cause of action. *Arthur v Davis* (1981) 126 CA3d 684, 691, 178 CR 920. Knowledge of a potential slander of title claim obtained by an attorney in the course of litigation is imputed to the parties represented by the attorney and starts tolling the statute of limitations. *Stalberg v Western Title Ins. Co.* (1991) 230 CA3d 1223, 1231, 282 CR 43.

The defense is subject to the doctrine of equitable tolling. In *Stalberg v Western Title Ins. Co.* (1994) 27 CA4th 925, 932, 32 CR2d 750, a title company knowingly created a 60-foot-wide fictitious easement for upstream property owners and recorded "wild deeds" encumbering the downstream owners' property with the easement. After discovering the easement, the downstream owners filed a quiet title action against the upstream owners, without being aware of the title company's role in creating the easement. In 1979, during the course of the action, the plaintiff's attorney discovered that the company had recorded the easement. The attorney then notified the company of the quiet title action. The slander of title action against the company was not filed until June 1993, more than three years after discovery of the company's potential liability.

The court of appeal reviewed the facts and applied the doctrine of equitable tolling. 27 CA4th at 934. In essence, if a plaintiff has more than one legal remedy and "reasonably and in good faith" pursues one remedy to mitigate damage, the doctrine will apply if the defendant has notice and is not prejudiced. The prejudice must affect the defendant's ability to defend the action on its merits. 27 CA4th at 933.

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§11.117 5. Good Faith Reliance on Advice of Counsel

When it is apparent that a conditional privilege applies to the defendant's conduct, the plaintiff must plead and prove malice. See §11.49. The plaintiff need not prove that the defendant acted with malice or ill will toward the plaintiff. *Gudger v Manton* (1943) 21 C2d 537, 543, 134 P2d 217, disapproved on other grounds in *Albertson v Raboff* (1956) 46 C2d 375, 381, 295 P2d 405; *Phillips v Glazer* (1949) 94 CA2d 673, 677, 211 P2d 37. Implied malice from knowledge of the falsity of the publication is sufficient. *Albertson v Raboff*, *supra*. In *Cavin Memorial Corp. v Requa* (1970) 5 CA3d 345, 361, 85 CR 107, the court held that the defendants could not be held liable for slander of title when they did not act maliciously, acted under advice of counsel, and believed that their execution of a deed was proper.

In *Palmer v Zaklama* (2003) 109 CA4th 1367, 1383, 1 CR3d 116, the court noted that the defense of advice of counsel required the defendants to prove that (1) they consulted a lawyer in good faith, (2) they stated all the facts to the lawyer, (3) the lawyer advised them that they have a good cause of action, and (4) they have honestly acted on the advice of the lawyer. The court further noted that counsel's advice must be sought in good faith, not withhold facts that would impair the action, and not be used as a mere cloak to protect one against a suit for malicious prosecution.

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§11.118 6. Lack of Publication by Defendant

A communication or a publication of allegedly disparaging remarks about title is an essential element of a claim of slander of title. *Southcott v Pioneer Title Co.* (1962) 203 CA2d 673, 676, 21 CR 917. Allegations that the defendant prepared a document and that an escrow was closed are insufficient to allege publication. 203 CA2d at 676. Although lack of publication is normally treated as an affirmative defense, if a complaint fails to allege publication, the defendant may demur based on failure to state a cause of action. 203 CA2d at 677.

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§11.119 7. Lack of Actual Damages

The allegation and proof of damages caused by the allegedly disparaging statement is essential to a claim for slander of title. *Burkett v Griffith* (1891) 90 C 532, 536, 27 P 527, disapproved on other grounds in 21 C2d at 556. A complaint lacking an allegation of actual damage is subject to a demurrer for failure to state facts sufficient to constitute a cause of action.

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§11.120 8. Venue

Although venue is not technically a defense, counsel should keep in mind that a slander of title claim is considered a local action and must be brought in the county in which the property is located. CCP §392; *Coley v Hecker* (1928) 206 C 22, 27, 272 P 1045; *Wick v Mattison* (1962) 207 CA2d 608, 609, 24 CR 677.

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C. Escrow Liability

§11.121 1. Statute of Limitations

A claim for breach of written contract against an escrow agent falls within the four-year statute of limitations in CCP §337. *Amen v Merced County Title Co.* (1962) 58 C2d 528, 532, 25 CR 65. The action will be considered a claim for breach of written contract even if the written contract was accepted orally or was based on a promise implied from the written contract. 58 C2d at 532.

A claim against an escrow agent based on an alleged breach of an oral contract is governed by the two-year statute of limitations in CCP §339. 58 C2d at 532.

When the claim against the escrow agent is based on negligence in the performance of its fiduciary duties, the statute of limitations is two years and begins to run from the date the negligence is discovered. 58 C2d at 532; *Iusi v City Title Ins. Co.* (1963) 213 CA2d 582, 588, 28 CR 893; *Kellum v San Mateo County Title Co.* (1932) 127 CA 276, 282, 15 P2d 876. See §11.47 for discussion of the substantive law of escrow liability.

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§11.122 2. Interpleader

Although not a defense per se, if the escrow agent is faced with conflicting demands from the parties to the escrow, the agent may file an action in interpleader to compel the parties to litigate their claims. The agent may deposit the disputed funds, documents, or property with the court and be discharged from liability.

An escrow agent who has been sued by one claimant to the property held in escrow may cross-complain against the plaintiff and the other claimants in interpleader and be discharged on payment or deposit with the court. CCP §386. The agent may also be discharged after payment or deposit with the court if it files an affidavit stating that it is a mere stakeholder under CCP §386.5. The court has discretion to award costs and reasonable attorney fees to the escrow agent. CCP §386.6.

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X. SUBROGATION

§11.123 A. Definition; Authority

Subrogation is a method by which an insurer acquires the right to recover from another party payments made to or on behalf of an insured. See, *e.g., Allstate Ins. Co. v Loo* (1996) 46 CA4th 1794, 1799, 54 CR2d 541. In subrogation, the paying insurer (the subrogee) steps into the shoes of the insured (the subrogor) and sues the persons who are wholly or partially liable for the loss covered by the insurer. Such persons may assert against the insurer defenses applicable against the insured. 46 CA4th at 1799.

Subrogation rights generally arise from legislation (see, *e.g.,* CCP §875(e); 11 USC §509), contract (the insurance policy), or common law principles of equity (see §§11.124-11.125). Other theories and remedies by which an insurer may recover payments made to or on behalf of an insured from the party legally responsible for the covered loss are contribution and indemnity. These methods are discussed and compared with the subrogation process in California Liability Insurance Practice: Claims & Litigation, chap 23 (Cal CEB 1991).

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B. Applicability to Title Insurance

§11.124 1. Contractual Subrogation

Title insurance policies, like other insurance contracts, uniformly contain subrogation clauses for the insurer's benefit (*e.g.,* Condition 12 of the CLTA policy and the 1992 and 2006 ALTA lender's policies and Condition 13 of the 1992 and 2006 ALTA owner's policies). In the context of title insurance, defendant parties sued in subrogation by the paying insurer are typically another title insurer, the grantor of an insured owner, an owner or a general contractor who made improvements to the insured property, the primary or secondary obligee of a lien senior to that of the insured interest, or a joint obligor of the insured.

EXAMPLE: In *American Title Co. v Anderson* (1975) 52 CA3d 255, 125 CR 24, persons who purported to be property owners conveyed their "title" to certain real property to an insured. Ultimately, in another action, it was found that the vendors did not have title to the subject property and the insureds had acquired nothing by the deed from the vendors. The insurer settled its claim with the insured and sued the vendors, based on its subrogation rights under the title policy. The court held that the vendors were liable to the insurer because "the sin of [the title insurer] was one of omission, while the sin of the [vendors] was one of commission and… was the genesis of the problem." 52 CA3d at 260. The court also noted that the title policy did not cause the failure of the title.

Even though an insurer may be negligent in failing to discover a title defect, the party responsible for the covered loss usually cannot maintain an action under negligence or third party beneficiary theories against a title insurer for its failure to discover the defect. *Kenny v Safeco Title Ins. Co.* (1980) 113 CA3d 557, 169 CR 808.

One issue in *Fidelity Nat'l Title Ins. Co. v Miller* (1989) 215 CA3d 1163, 264 CR 17, was whether the insured buyer and the title insurer would be precluded from recovery and subrogation for the vendor's breach of the implied covenants in a grant deed because both the buyer and the insurer had known before escrow closed of the possibility of an encumbrance on title. The court relied in part on California Real Property Sales Transactions §11.7 (3d ed Cal CEB 1998) (now California Real Property Sales Transactions §12.7 (4th ed Cal CEB 2007)) to hold that (215 CA3d at 1171 n3):

> [A] grant deed to encumbered property without words of restraint breaches this covenant. The seller may not defend on the ground that the buyer had notice from the preliminary title report or otherwise; the action is on breach of contract and does not require a showing of reliance or misrepresentation.

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§11.125 2. Equitable Subrogation

Another basis for subrogation rights is the law of equity. In the absence of a statute or an agreement providing for subrogation rights, a court may apply the doctrine of equitable subrogation. *Caito v United Cal. Bank* (1978) 20 C3d 694, 144 CR 751.

EXAMPLES: Cases considering equitable subrogation and defenses to it in the title insurance context are:

- *In re Spirtos* (Bankr CD Cal 1989) 103 BR 240 (title insurer recovered defense costs under doctrine of equitable subrogation from debtor in bankruptcy); and
- *Lawyers Title Ins. Corp. v Feldsher* (1996) 42 CA4th 41, 49 CR2d 542 (title insurer not entitled to equitable subrogation, because its insured, an experienced lender, had actual knowledge of senior lien and was inexcusably negligent). For further discussion of *Feldsher,* see 19 CEB Real Prop L Rep 212 (Oct. 1996).

Three decisions of the Court of Appeals for the Ninth Circuit are relevant to subrogation rights against IRS tax liens. In the first, *Fidelity Nat'l Title Ins. Co. v U.S.* (9th Cir 1990) 907 F2d 868, the court ruled in favor of the IRS on an action brought by a title insurer and its insured purchaser who sought to establish priority, under a theory of equitable subrogation, over an IRS lien. The subject property, encumbered by the IRS lien in fourth position, was sold at a trustee's sale foreclosure on the first deed of trust. The purchaser then sold the property. Both the purchaser at the foreclosure sale as well as the subsequent purchaser were unaware of the IRS lien on the property. The lien was not extinguished by the foreclosure, because notice of the sale was not given to the IRS. 26 USC §7425(b). Although the Internal Revenue Code generally provides that the IRS will recognize a person's state law subrogation rights, the *Fidelity* decision turned on the fact that the property had been purchased at a foreclosure sale. 907 F2d at 870.

In the second, *Han v U.S.* (9th Cir 1991) 944 F2d 526, however, the court held that purchasers were equitably subrogated to the priority position of a lien they had paid when they bought the property. The vendors and their Realtor had actual knowledge of the existence of the junior IRS lien, but did not disclose it to the buyers. After the sale, the IRS levied on the real property. The buyers then filed an action that sought, among other things, declaratory relief and equitable subrogation. The application of the doctrine of equitable subrogation resulted in the buyers being awarded a lien position superior to that of the IRS, in the amount of the first deed of trust they paid as a portion of their purchase price, and of all other liens and encumbrances recorded before the IRS lien that were paid from the proceeds of the sale. 944 F2d at 531.

In the third, *Mort v U.S.* (9th Cir 1996) 86 F3d 890, 894, an IRS lien was recorded after a party named Kern made a secured loan and recorded a deed of trust. Kern's loan was subsequently discharged when Belmont made a loan secured by the same property. Belmont's title insurer failed to discover the IRS lien and (in a subsequent transaction) transferred the title policy to Mort, who purchased the Belmont loan and was assigned the Belmont deed of trust. Although the Belmont deed of trust was recorded after the IRS lien, the court applied the doctrine of equitable subrogation and held that the assignee of the Belmont note and deed of trust (Mort) was entitled to the priority position of the original secured lender (Kern).

The cases of *Mort* and *Han* are distinguishable from *Fidelity* because the property in *Fidelity* was purchased at a foreclosure sale. *Han v U.S.* (9th Cir 1991) 944 F2d 526, 530 n2; *Mort v U.S.* (9th Cir 1996) 86 F3d 890, 894 n3. Based on these cases, purchasers and lenders, and their title insurers, face different subrogation rules, at least with respect to IRS liens, depending on the nature of the transaction.

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§11.125A 3. No Right to Subrogation Under the California Real Estate Recovery Fund

Although there is no California decision on point, a recent Ninth Circuit case held a title insurer that has paid an insured under a title policy has no right to subrogation against the responsible third party under the California Real Estate Recovery Account Fund (Bus & P C §§10471-10481). This fund was created to "protect the public against loss resulting from misrepresentation and breach of fiduciary duty by real estate brokers who are unable to respond to damage awards." *Antonio v Hempel* (1977) 71 CA3d 128, 130, 139 CR 309.

In *Stewart Title Guar. Co. v Park* (9th Cir 2001) 250 F3d 1249, a mortgage broker was required to pay off existing liens on a refinancer's properties so that the refinanced loans would be secured by first trust deeds. The mortgage broker received the funds for the escrow accounts, but rather than paying off existing liens, embezzled the loan proceeds. The title insurer was obligated to protect the insured lenders against loss of priority to the full extent of the loss, up to the face amount of the policies. The title insurer therefore paid off the preexisting liens after the mortgage broker failed to do so. The Ninth Circuit, applying California law, held that the title insurer was not an "aggrieved person" as that term is used in the statute, as case law had limited that term to clients of real estate professionals or members of the general public. 250 F3d at 1253. Further, the court held that the title insurer was not entitled to payment from the fund as a subrogee of the aggrieved party lender. The court noted that aggrieved persons have no right to recovery until they have exhausted all other avenues of relief. Bus & P C §10471(c)(7)(E). Because the title insurer's payments made the aggrieved party lender whole, the lender was not eligible for relief, and thus the title insurer had no right to subrogation. 250 F3d at 1254.

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§11.126 C. Declaratory Relief

An insurer who has subrogation rights under its policy with the insured need not pay the insured on the policy as a condition precedent to bringing an action for declaratory relief to determine the liability of a third party tortfeasor. See *Liberty Mut. Ins. Co. v Harris, Kerr, Forster & Co.* (1970) 10 CA3d 1100, 1104, 89 CR 437. See also *Plut v Fireman's Fund Ins. Co.* (2000) 85 CA4th 98, 106, 102 CR2d 36. However, an action by the insurer for a money judgment against the third party is not available unless the insurer pleads and proves payment. See *Iusi v City Title Ins. Co.* (1963) 213 CA2d 582, 28 CR 893.

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12

Claims Procedures Under Title Insurance Policies

Theodore R. Forrest, Jr.
Timothy R. Sullivan

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§12.1 I. INTRODUCTION

Because many title insurance claims may be resolved during the claims process without litigation, this chapter discusses claims procedures as a topic separate and distinct from formal title insurance arbitration or litigation procedures. For discussion of court litigation procedures, see chap 13. For discussion of arbitration procedures, see chap 14. The substance of claims and litigation theories and defenses is discussed in chap 11.

Claims against a title insurance company fall into two basic categories:

- Those that arise from insured interests set forth in a title insurance policy; and
- Tort and contract claims that either are policy related (*e.g.,* those arising from the insurer's mishandling of covered claims) or arise from the title company's performance of related functions (*e.g.,* escrow agent, abstractor of title).

The claims procedures discussed in this chapter generally apply to the first category of claims whether the claim is initiated by an insured (first party) or a third party. See §11.3. Although third parties are not bound by the claims procedures set forth in the title policy, an insured who gives notice to the insurer of a claim must comply with the notice provisions of the policy whether it is a first or third party claim. The insurer's response to both first and third party claims is governed by statutes, regulations, and the common law. See §§12.24-12.38. For definitions of first and third party claims, see §11.3.

The claims procedures discussed in this chapter need not be followed for presenting the tort and contract claims described in the second category of claims. Some of them (*e.g.,* disputes related to an insurer's handling of a covered claim) may not arise until the claims process is well under way. All known grounds for liability against a title insurance company may be combined in a single notice of claim, which is often presented in the form of a demand letter.

The claims process is a curious hybrid that may be collaborative, adversarial, or both. On one hand, the insurer may promptly acknowledge coverage and make arrangements for the efficient elimination of a title defect. For example, the defect may be cured by recording previously unrecorded satisfaction of liens or by paying off a prior encumbrance that is not excepted from the policy and for which coverage is clear. On the other hand, the claims process may become quite complex when coverage is in doubt. In such cases, both the claimant and the insurer may become involved in elaborate investigations and prelitigation discovery.

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§12.2 A. Reciprocal Duty of Good Faith and Fair Dealing

Both the insurer and the insured continue to be parties to the executory contract of insurance throughout the claims process, and each continue to owe to each other the usual duties of good faith and fair dealing implicit in all California contractual relationships. *Gruenberg v Aetna Ins. Co.* (1973) 9 C3d 566, 575, 108 CR 480; *Kapelus v United Title Guar. Co.* (1971) 15 CA3d 648, 653, 93 CR 278. In fact, the California Supreme Court has held that the duty of good faith and fair dealing continues (at least for the insurer and probably for both parties) during the course of litigation between the insurer and insured despite the frankly adversarial relationship that arises once formal litigation begins. See *White v Western Title Ins. Co.* (1985) 40 C3d 870, 885, 221 CR 509.

The insured also has an express contractual duty to cooperate with the insurer's investigation. See §12.40. See §§11.105-11.105B on the nature of the insured's duties under the covenant of good faith.

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Source: Real Property/California Title Insurance Practice/12 Claims Procedures Under Title Insurance Policies/§12.3 B. Overview of Claims Process

§12.3 B. Overview of Claims Process

The claims process typically begins when an insured provides notice of the claim to the insurer. See §§12.4-12.12. If a third party action has been brought against the insured, tender of defense must be made in a timely manner. See §§12.13-12.15. Standard title policies also require that the insured provide a written proof of loss to the insurer. See §§12.16-12.17. Depending on the nature of the claim, the insurer may be required to undertake extensive factual investigation. See §§12.24-12.26. The insurer may require the insured to submit to an examination under oath and to produce records pertaining to the loss or damage. See §12.42. The insurer must then make a coverage determination.

If the insurer determines that the claim is not covered under the policy, it may reject the claim. If the insured does not agree with the insurer's position, a lengthy dialogue may follow, culminating in a declaratory relief action to resolve the coverage issues. If the insurer determines that the claim or loss is covered, it must respond in one of several ways, depending on the nature of the claim or loss. It may:

- Seek to eliminate the defect;
- Pay the loss or damage;
- Defend the insured;
- Prosecute a quiet title action;
- Purchase the indebtedness; or
- Pay the policy limits.

If the insurer agrees that the claim is covered but that the insured has not yet suffered loss or damage, the insurer may simply agree to indemnify the insured against future loss or damage. The choice among all these options depends on the nature of the loss or damage and the facts of the claim. Various options may be pursued concurrently, *e.g.,* a partial cure of the title defect and mitigation of damage. See §12.47.

When the claim does not involve a lawsuit against the insured, the insurer's choices are based on actual coverage under the title policy. When the claim does involve litigation against the insured, the insurer's defense obligation arises if the loss or damage is potentially covered by the policy. *Paramount Props. Co. v Transamerica Title Ins. Co.* (1970) 1 C3d 562, 570, 83 CR 394; *Rosen v Nations Title Ins. Co.* (1997) 56 CA4th 1489, 1496, 66 CR2d 714; *Israelsky v Title Ins. Co.* (1989) 212 CA3d 611, 620, 261 CR 72; *Safeco Title Ins. Co. v Moskopoulos* (1981) 116 CA3d 658, 664, 172 CR 248; *Jarchow v Transamerica Title Ins. Co.* (1975) 48 CA3d 917, 942, 122 CR 470, overruled on other grounds in 184 CA3d at 434; *Kapelus v United Title Guar. Co.* (1971) 15 CA3d 648, 653, 93 CR 278. See §12.27.

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II. PROVIDING NOTICE OF CLAIM

§12.4 A. Contents of Notice

The title industry has standardized provisions of title policies through the California Land Title Association (CLTA) and the American Land Title Association (ALTA), which develop and publish the most widely used forms.

Under Condition 3 of Part II (Conditions and Stipulations) of the 1990 CLTA standard coverage policy (CLTA policy; see App H), an insured must provide written notice:

- Of any litigation in which a third party asserts an adverse interest in the insured's title;
- Of any knowledge by the insured of any claim of title or interest adverse to that of the insured; or
- Whether title, as insured, "is rejected as unmarketable."

Condition 3(a) of the CLTA/ALTA Homeowner's Policies (see App O) requires that the insurer be given written notice of "anything that might be covered by this Policy." These policies state that the notice must be given by "You," which is defined to mean the named insured. Condition 3(a) of the 1987 ALTA Residential Policy (see App M) requires that the insurer be given notice "[i]f anyone claims a right against your title…." That policy states that the notice must be given by "you," but does not define the term.

The language in Condition 3 of the 1992 and 2006 ALTA loan policies (ALTA lender's policy; see App I and App J) and Condition 3 of the 1992 and 2006 ALTA owner's policies (ALTA owner's policy; see App K and App L) are almost identical to that in the CLTA policy except that the ALTA policies refer to notice being given by "the insured" rather than "an insured." This distinction is discussed in §12.7.

Under Condition 16 of the CLTA policy and the 1992 ALTA lender's policy, Condition 17 of the 1992 ALTA owner's policy, Condition 3(a)(2) of the CLTA/ALTA Homeowner's policies, and Condition 3(a) of the 1987 Residential policy, all notices required to be given to the title insurer or escrow company must refer to the policy number. Under Condition 4 of the CLTA policy, the insurer must defend any litigation in which any third party asserts a claim adverse to the title or interest as insured "upon written request by an insured." Condition 4 of the 1992 ALTA lender's and owner's policies and Condition 5 of the 2006 ALTA lender's and owner's policies contain similar language, although all four policies refer to a defense request from "the insured" rather than "an insured." Neither the 1987 Residential policy nor the CLTA/ALTA Homeowner's policies contain any reference to a request for a defense. Thus, some insurers may take the position that the policy requires not only written notice of litigation but also an express request for a defense. The notice and defense request may be combined in a single document. On tendering defense of a third party action, see §§12.13-12.15.

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§12.5 B. Mandatory Written Notice

Condition 3 of the CLTA policy, and Conditions 3, 4 and 5 of the 1992 and 2006 ALTA policies require that the notice of claim, request for defense, and proof of loss all be in writing. Condition 4 in the 1987 Residential policy and Conditions 3(a) and 3(b) in the CLTA/ALTA Homeowner's policies also require that notices and proof of loss be in writing. Arbitrators or courts may be inclined, however, to find a waiver of (or estoppel to assert) the requirement of written notice if the insurer does not object to oral notice. *Hall v San Jose Abstract & Title Ins. Co.* (1959) 172 CA2d 421, 342 P2d 362. See §12.12.

These requirements are consistent with the Fair Claims Settlement Practices Regulations (10 Cal Code Regs §§2695.1-2695.14), effective January 14, 1993. Although 10 Cal Code Regs §2695.2(n) states that "notice of claim" may be verbal or written, an insurer may require that the notice be given in writing if the policy or an endorsement to it provides for written notice. 10 Cal Code Regs §2695.5(f). The notice of claim need only apprise the insurer that the claimant wishes to make a claim against a policy issued by the insurer and that a condition giving rise to the insurer's obligations under that policy may have arisen. 10 Cal Code Regs §2695.2(n). Under these regulations, the "notice of claim" triggers the time limits for the insurer to acknowledge receipt of the notice, begin its investigation, and affirm or deny coverage and liability. Under 10 Cal Code Regs §2695.2(n), however, the notice of claim may not include any written or verbal communication provided by an insured or a principal "solely for informational or incident reporting purposes."

PRACTICE TIP: To avoid any dispute over the form of the notice, the insured's attorney is advised to comply with the policy requirement that notice be in writing and be sent to the address specified in the policy. Further, if the claim involves litigation against the insured, the attorney should be careful to state explicitly that the insured is requesting the insurer to provide a defense. See §12.13. In addition, to avoid any claim that the insurer did not receive notice of the claim, the attorney should consider sending written notice by certified mail or any method that provides proof of delivery.

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§12.6 C. Delivery of Notice

Condition 16 of the CLTA policy and the 1992 ALTA lender's policy, Condition 17 of the 1992 ALTA owner's policy and 2006 ALTA lender's policy, Condition 18 of the 2006 ALTA owner's policy, and Condition 3(a) in both the 1987 Residential policy and the CLTA/ALTA Homeowner's policies contain a blank space for the insurer to insert the address where notices of claims should be sent. If the title insurer and escrow company are separate entities and the insured has had more contact with escrow company representatives than with the title insurer, the insured may be more inclined to send notice to the escrow company—especially if the insured is not able to locate a copy of its title policy. Presumably, the escrow company will forward any notice received to the title insurer. If the escrow company fails to forward the notice, however, a question may arise about whether the title insurer may refuse to defend the claim based on lack of notice. The answer may depend on whether the escrow company is an underwritten title company or is considered to be an agent of the title insurer.

The insurance regulations indicate notice may be given to the insurer "or its agent." 10 Cal Code Regs §2695.2(n). Further, with one exception not applicable to title insurers, the regulations provide that the failure of an insurance agent or a claims agent to transmit promptly a notice of claim to the insurer is "imputed to the insurer." 10 Cal Code Regs §2695.5(e)(1). Presumably, this means that the insurer would be estopped from asserting late notice as a coverage defense if the escrow company is an "insurance agent" or a "claims agent." The term "insurance agent" is defined as follows: (1) as that term is used in Ins C §§31, 32; (2) any person who has authority or responsibility to notify an insurer of a claim upon receipt of a notice of claim; or (3) an underwritten title company. 10 Cal Code Regs §2695.2(h). The term "claims agent" is defined as any person authorized by an insurer to conduct an investigation of a claim. 10 Cal Code Regs §2695.2(d).

Thus, if an underwritten title company fails to forward the notice of claim to the title insurer, the title insurer would presumably be estopped from asserting breach of the notice condition. See, *e.g.,* 10 Cal Code Regs §2695.5(e). Likewise, if the escrow company is found to be a claims agent or an insurance agent for the insurer, any notice sent to the escrow company should be sufficient notice to the insurer. See CC §2332; 10 Cal Code Regs §2695.5(e). See also *Zurich Ins. Co. v Killer Music, Inc.* (9th Cir 1993) 998 F2d 674, 679 (applying California law; notice to agent sufficient when agent's address was only address on policy); *General Acc. Assur. Co. v Caldwell* (9th Cir 1932) 59 F2d 473 (evidence admitted to show that broker acted as agent of insurer regarding notices of loss).

PRACTICE TIP: The preferred method is for the insured to send a notice of claim directly to the title insurer. If the policy cannot be located or if for any reason notice must be sent initially to an escrow agent who did not issue the policy, the notice should include a request that the agent immediately forward the notice to the insurer and provide the claimant with the insurer's claims address. Even if this step does not increase the insured's rights vis-à-vis the title insurer, if the escrow agent fails to forward the notice or provide the address, the insured may assert that the agent breached a fiduciary obligation or other duty owed to the insured. Note, however, that the escrow agent may argue, once escrow closes, that it has no duty to process or forward notices of claims.

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§12.7 D. Notice Providers

The notice provision in Condition 3 of the 1990 CLTA policy contains one small but possibly significant difference from the 1973 version of that policy and other standard policies. Notably, Condition 3 in the 1973 version, and Condition 3 in the 1992 and 2006 ALTA lender's and owner's policies refer to notice being provided by "the insured." Similarly, Condition 3(a) of the CLTA/ALTA Homeowner's policies refers to notice being provided by "You," defined to mean the named insured. Condition 3(a) of the 1987 Residential policy refers to notice being provided by "you," but does not define "you." In contrast, Condition 3 of the 1990 CLTA policy refers to notice being provided by "an insured." This subtle change raises interesting issues.

In interpreting various exclusions in liability policies, some courts have found the term "the insured" to be ambiguous, because it could refer (1) only to the named insured or (2) to any insured seeking coverage under the policy. See *State Farm Mut. Auto. Ins. Co. v Jacober* (1973) 10 C3d 193, 196, 110 CR 1; *National Union Fire Ins. Co. v Lynette C.* (1991) 228 CA3d 1073, 1079, 279 CR 394. See also *California State Auto. Ass'n Inter-Ins. Bureau v Warwick* (1976) 17 C3d 190, 130 CR 520 ("any insured" not ambiguous).

The change in the 1990 CLTA policy's notice condition from "the insured" to "an insured" appears to recognize the fact that any insured may provide the required notice. Like the 1973 version of the CLTA policy, the 1990 CLTA policy further provides that, if prompt notice is not given,

> then as to that 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.

The 1992 and 2006 ALTA lender's and owner's policies contain similar language, except that they refer to the reduction or termination of liability, and to "the Insured" or "the Insured Claimant" rather than to "that insured."

Under other types of insurance policies, California courts have been reluctant to find a forfeiture of the insured's right to coverage based on lack of notice or late notice. Indeed, some courts have refused to allow an insurer to deny coverage based on breach of the notice condition when the insurer has received notice from any source—whether that source is another insured, the adverse claimant, or the insurer's own investigation. See *California Shoppers, Inc. v Royal Globe Ins. Co.* (1985) 175 CA3d 1, 37, 221 CR 171 (constructive notice arose on insurer's receipt of envelope with no cover letter enclosing complaint against one insured, even though envelope bore return address of different insured covered by separate policy). See §12.13.

It is difficult to imagine a situation in which one insured would give notice of a claim to the title insurer, who would then be able to establish actual prejudice based on the fact that a different insured had not also given notice of the claim. Conceivably, this could occur when one insured learned of a title defect well before another insured learned of it. For example, under a CLTA joint protection policy, if a property owner became aware of an alleged easement over his or her property and did not notify the insured mortgage holder or the title insurer, the mortgage holder might not learn of the alleged easement until the holder of the easement filed suit or took other enforcement action. The insured mortgage holder might then promptly notify the title insurer of the claim. In this situation, the language of the notice condition quoted above might exculpate the insurer from liability to the insured who had prior knowledge but failed to notify the insurer—but only to the extent of prejudice to the insurer. See §§12.8-12.10.

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§12.8 E. Denial of Claim Based on Inadequate Notice

Condition 3 of the CLTA and of the 1992 and 2006 ALTA owner's and lender's policies provides that inadequate notice justifies the denial of a claim by the insurer only to the extent it is substantially prejudiced. See quote in §12.7. Even if an insurer proves that it has been substantially prejudiced by an untimely or inadequate notice of a claim, an automatic and complete denial of the claim is not necessarily justified. Identical language in Condition 3 of the CLTA policy and the 1992 ALTA owner's and lender's policies provides that if the insurer is prejudiced by an insured's failure to provide prompt notice, the insured's rights under the policy are affected "only to the extent of the prejudice" resulting to the insurer. Condition 3 of the 2006 ALTA owner's and lender's policies provides that, if the company is prejudiced by the insured's failure to provide prompt notice, the insurer's liability to the insured "shall be reduced to the extent of the prejudice." Conditions 3(a) and 3(b) of the 1987 Residential policy state that the insurer's obligation could be reduced if the insured fails to give prompt notice or fails to provide a statement of loss, answer questions under oath, or produce documents the insurer requests, and "your failure affects our ability to dispose of or defend you against the claim." Conditions 3(a) and 3(b) of the CLTA/ALTA Homeowner's policies contain similar language. Decisional law has ruled that an insurer cannot establish breach of the notice condition unless the insurer was substantially prejudiced by that breach. Prejudice cannot be presumed as a matter of law from the breach, and the burden of proving the prejudice is on the insurer. This burden cannot be carried by showing the mere possibility of prejudice. *Belz v Clarendon Am. Ins. Co.* (2007) 158 CA4th 615, 631, 69 CR3d 864; *Moe v Transamerica Title Ins. Co.* (1971) 21 CA3d 289, 302, 98 CR 547. See also *American Int'l Specialty Lines Ins. Co. v Continental Cas. Ins. Co*. (2006) 142 CA4th 1342, 1366, 49 CR3d 1; §11.89.

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§12.9 1. Third Party Claims

In third party claims, the burden of proving substantial prejudice can be met only by establishing the substantial likelihood that the trier of fact would have found in the insured's favor, or that the insurer could have settled for a smaller sum. *Belz v Clarendon Am. Ins. Co.* (2007) 158 CA4th 615, 632, 69 CR3d 864; *Northwestern Title Sec. Co. v Flack* (1970) 6 CA3d 134, 141, 85 CR 693. See 3 Miller & Starr, California Real Estate §7:98 (3d ed 2000). "[P]rejudice is not shown simply by displaying end results; the probability that such results could or would have been avoided absent the claimed default or error must also be explored." *Clemmer v Hartford Ins. Co.* (1978) 22 C3d 865, 883 n12, 151 CR 285. See *Shell Oil Co. v Winterthur Swiss Ins. Co.* (1993) 12 CA4th 715, 762, 15 CR2d 815.

In *Collin v American Empire Ins. Co.* (1994) 21 CA4th 787, 819, 26 CR2d 391, the court identified a number of factors demonstrating the resulting prejudice to the insurer because of the insured's failure to provide notice of a third party claim:

- The amount of the default judgment entered against the insured was substantially higher than the actual damages suffered by the third party claimant;
- The default precluded the insurer from presenting any defense at the prove-up hearing;
- The basis for the default judgment was not supported by the evidence; and
- The default precluded the insurer from presenting evidence that might have completely exonerated the insured.

In *Shell Oil Co. v Winterthur Swiss Ins. Co.* (1993) 12 CA4th 715, 761, 15 CR2d 815, although the court concluded that the insurer had not carried its burden, the court stated that substantial prejudice could be proved if the insurer established that "but for the delay" in making a prompt investigation and hiring an attorney, there was a substantial likelihood that the insurer could have prevailed in the underlying action brought against the insured or that the insurer could have settled the case for a small sum or a smaller sum. See *Belz v Clarendon Am. Ins. Co., supra*; *Northwestern Title Sec. Co. v Flack, supra*.

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§12.10 2. First Party Claims

The authors are unaware of any authority illustrating how an insurer can demonstrate prejudice resulting from delay in receiving notice of a first party claim, *i.e.,* a claim in which the insured discovers a title defect or the insured's title is rejected as unmarketable. Proving prejudice from delay in such cases would probably be quite difficult. The authors believe that the insurer would be required to demonstrate that it could have either eliminated the defect or minimized the loss but for the insured's failure to provide earlier notice of the defect.

EXAMPLE: In a boundary dispute, the insured's neighbor used part of the insured's property and claimed that it belonged to the neighbor. If the insured does nothing, it might lose the disputed portion through adverse possession. If the insured subsequently made a claim under the title policy for loss of the disputed portion, the insurer might be able to prove prejudice by demonstrating that, had the insured notified the insurer sooner, the insurer would have brought a quiet title action and prevented the neighbor from acquiring the disputed portion through adverse possession.

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F. Waiver of Defects in Notice

§12.11 1. Insurer's Denial of Coverage

If the insurer denies coverage under the policy, that denial constitutes a waiver of the notice condition. *Clemmer v Hartford Ins. Co.* (1978) 22 C3d 865, 883, 151 CR 285; *Shell Oil Co. v Winterthur Swiss Ins. Co.* (1993) 12 CA4th 715, 762, 15 CR2d 815; *Lagomarsino v San Jose Abstract & Title Ins. Co.* (1960) 178 CA2d 455, 460, 3 CR 80; *Overholtzer v Northern Counties Title Ins. Co.* (1953) 116 CA2d 113, 123, 253 P2d 116. The rationale for this waiver rule is that an insurer that denies coverage presumably had enough information to make a fully informed decision and therefore presumably was not prejudiced by the defective notice.

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§12.12 2. Insurer's Failure to Object

An insurer that fails to object specifically and promptly to defects in a notice or proof of loss waives the defects. Ins C §553. An insurer waives the late presentation of a notice or proof of loss if the delay is caused by either an act of the insurer or the insurer's failure to object specifically and promptly on that ground. Ins C §554. See *Lagomarsino v San Jose Abstract & Title Ins. Co.* (1960) 178 CA2d 455, 459, 3 CR 80 (five-year delay in objecting to oral notice of claim waived title insurer's right to demand written notice of claim or statement of loss). See also §12.22.

For a more comprehensive discussion of waiver and estoppel to avoid the harsh results of a defective notice of claim or proof of loss, see California Liability Insurance Practice: Claims & Litigation §8.32 (Cal CEB 1991).

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Source: Real Property/California Title Insurance Practice/12 Claims Procedures Under Title Insurance Policies/ III. TENDERING THE DEFENSE/§12.13 A. Definition of 'Tender'

III. TENDERING THE DEFENSE

§12.13 A. Definition of "Tender"

There is no authoritative definition of a "tender of defense." Generally speaking, a tender of defense is a notice to the insurer that legal action has been brought against the insured (see §§12.4-12.12), coupled with a request that the insurer defend the insured. None of the standard language policies ever use the term "tender." Instead, Condition 4 of the CLTA policy and the 1992 ALTA owner's and lender's policies and Condition 5 of the 2006 ALTA owner's and lender's policies all refer to the insured making a written request for a defense. No specific words are mandated in the policies to constitute a tender or request for a defense. Notably, neither the 1987 Residential policy nor the CLTA/ALTA Homeowner's policies refer to a tender of defense or even a written request for a defense.

In *Employers Mut. Liab. Ins. Co. v Pacific Indem. Co.* (1959) 167 CA2d 369, 382, 334 P2d 658, the appellate court implied that an insurer's duty to defend could be triggered without a tender from the insured. In that case, Atkinson was insured under a business liability policy issued by Employers Mutual and under an automobile liability policy issued by Pacific Indemnity. After Employers Mutual received notice of a suit against Atkinson, Employers Mutual tendered Atkinson's defense to Pacific Indemnity. After Pacific Indemnity refused to defend Atkinson, Employers Mutual contributed to a settlement of the claim against Atkinson. The appellate court held that Pacific Indemnity could not defeat Employers Mutual's subsequent subrogation action by asserting lack of notice from Atkinson, noting that Pacific Mutual failed to show any prejudice either from delay in receiving notice or from the fact that the notice was provided by Employers Mutual rather than Atkinson.

An insurer's duty to defend may also arise when the insurer has constructive notice of the claim. For example, in *California Shoppers, Inc. v Royal Globe Ins. Co.* (1985) 175 CA3d 1, 37, 221 CR 171, California Shoppers and Adco were related entities with common ownership. They each had separate policies with Royal Globe. California Shoppers was sued in an action in which Adco was not named and forwarded the summons and complaint to the insurance agent in an Adco envelope with no cover letter. Without further inquiry, Royal Globe concluded that Adco, which was not named in the lawsuit, had tendered the claim for defense, and sent a letter to Adco refusing to defend. The appellate court held that the insurer had received sufficient facts to place it on constructive notice of the claim and impose a duty to make further inquiry. Thus, the court concluded, the insurer had breached its duty to defend. The court ruled, however, that actual notice, not constructive notice, was required to support bad faith liability by the insurer. 175 CA3d at 38. In contrast, another appellate court held that an insurer has no duty to investigate a claim if the insured fails to make a good faith effort to comply with the policy's notice requirements. See *Paulfrey v Blue Chip Stamps* (1983) 150 CA3d 187, 197 CR 501.

PRACTICE TIP: One practical lesson to be learned from *California Shoppers, Inc. v Royal Globe Ins. Co., supra,* is that the insured expended substantial sums defending the third party action before the appellate court ruled on the issue of the insurer's duty to defend, and recovered those sums as damages for the insurer's breach of that duty. This result underscores the importance of an express and timely, written tender by the insured as well as the insurer's prompt investigation. The insurer is generally not responsible for pre-tender defense costs. See §12.15. At a minimum, the insurer will attempt to avoid paying any pre-tender defense fees and costs "voluntarily" incurred by the insured. Some attorneys delay tendering the defense to an insurer until they have conducted their own research and analysis of the policy. At the very least, however, the insured's attorney should immediately tender to the title insurer any suit involving a title defect to start the clock running on the insurer's duties to investigate and defend. If further information, explanation, or citation to legal authorities are required by the insurer, they can be provided as soon as possible. No particular words are required to constitute a tender of defense, but the attorney should be sure that a request for defense is clearly communicated so that the insurer cannot claim that the insured was simply requesting information or reporting an incident. See 10 Cal Code Regs §2695.2(n).

For additional discussion on the content and manner of tendering the defense of third party actions, see California Liability Insurance Practice: Claims & Litigation §8.23 (Cal CEB 1991).

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§12.14 B. Forfeit of Defense and Indemnity Rights Caused by Late Tender

Prompt tender of defense of the claim is important. If the insurer is able to demonstrate prejudice from any delay by the insured in tendering the claim, the insured may forfeit not only the right to defense but also the right to indemnity under the policy. *Select Ins. Co. v Superior Court* (1990) 226 CA3d 631, 639, 276 CR 598. As noted in §§12.8-12.9, the insurer bears the burden of proving substantial prejudice from the delay. 226 CA4th at 636.

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§12.15 C. Recoverability of Pre-Tender Fees

Many types of liability policies contain a "voluntary payments" provision such as: "The insured shall not, except at the insured's own cost, voluntarily make any payment, assume any obligation, or incur any expense other than for first aid to others at the time of the bodily injury." Neither the CLTA standard coverage policy nor the ALTA policies contain a voluntary payments provision. The most comparable provision is Condition 8(c) of the CLTA policy, which states:

> 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.

Identical language may be found in Condition 8(c) of the 1992 ALTA lender's policy and Condition 9(c) of the 1992 ALTA owner's policy. Condition 9(c) of the 2006 ALTA owner's and lender's policies contains the same language, except that "any insured" is replaced by "the Insured."

This condition says nothing about defense fees incurred by the insured before tendering the defense to the insurer. Despite the absence of a voluntary payments provision, however, some courts might conclude that the insurer has no duty to pay pre-tender defense fees based on case law that the duty to defend does not arise until the insurer has been provided with notice of the claim. See, *e.g., Gribaldo, Jacobs, Jones & Assoc. v Agrippina Versicherunges, A.G.* (1970) 3 C3d 434, 450, 91 CR 6; *Xebec Dev. Partners, Ltd. v National Union Fire Ins. Co.* (1993) 12 CA4th 501, 566, 15 CR2d 726, disapproved on other grounds in *Essex Ins. Co. v Five Star Dye House, Inc.* (2006) 38 C4th 1252, 1265 n4, 45 CR3d 362; *Northern Ins. Co. v Allied Mut. Ins. Co.* (9th Cir 1992) 955 F2d 1353, 1360.

Even if a court concluded that such "voluntary" pre-tender fees need not be borne by the insurer, the issue of whether such fees were voluntarily incurred may be a question of fact. For example, in *Fiorito v Superior Court* (1990) 226 CA3d 433, 277 CR 27. The court refused to rule that pre-tender defense fees cannot be recovered from the insurer as a matter of law. The claimants in the case contended that they were "compelled" to incur defense fees and costs to respond to legal process and protect their interests while at the same time they searched for the insurance policies. The court concluded that these contentions raised a question of fact regarding whether the fees had been voluntarily incurred. 226 CA3d at 438. See also *Shell Oil Co. v National Union Fire Ins. Co.* (1996) 44 CA4th 1633, 1649, 52 CR2d 580 (pre-tender defense costs not voluntary during period insured was unaware of either its insurer's identity or contents of policy; *Jamestown Builders, Inc. v General Star Indem. Co.* (1999) 77 CA4th 341, 348, 91 CR2d 514 (pre-tender payments were involuntary when insured was unaware of identity of insurer or contents of policy). When the facts are undisputed, however, voluntariness may be decided as a question of law. *Tradewinds Escrow, Inc. v Truck Ins. Exch.* (2002) 97 CA4th 704, 710, 118 CR2d 561 (payments were voluntary as a matter of law when delay in tender of defense was because insured believed policy did not cover loss).

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IV. PROVIDING PROOF OF LOSS

§12.16 A. Definition of "Proof of Loss"

Condition 5 of the CLTA standard coverage policy, Condition 5 of the 1992 ALTA owner's and lender's policies, and Condition 3(b) of the 1987 Residential policy and the CLTA/ALTA Homeowner's policies require submission of a written proof of loss. The proof of loss must be signed and sworn, and describe the covered loss, and state the amount of the loss and the method used to calculate that amount.

Condition 5 of the 2006 ALTA owner's and lender's policies does not automatically require a proof of loss from the insured claimant. Instead, the insurer must first attempt to determine the amount of the loss and, if it is unable to do so, may then require the insured claimant to furnish a signed proof of loss. There is no requirement that the proof of loss be sworn.

The term "proof of loss" is not defined in any of the policies. In the insurance industry, this term is understood to mean a sworn statement required in a first party claim and includes the amount of the claim as well as a statement of facts and the production of available documents supporting the existence and amount of the claim.

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§12.17 B. Contents of Proof of Loss

Condition 5 of the CLTA policy and the 1992 ALTA owner's and lender's policies requires that the proof of loss or damage "describe the defect in, or lien or encumbrance on the title, or other matters" for which coverage is provided by the terms of the policy and "state, to the extent possible, the basis for calculating the loss or damage." Condition 4 of the 2006 ALTA owner's and lender's policies similarly requires that the proof of loss "describe the defect, lien, encumbrance, or other matter insured against" by the policy and "state, to the extent possible, the basis of calculating the amount of the loss or damage." Condition 3(b) of the 1987 Residential policy and the CLTA/ALTA Homeowner's policies likewise requires the proof of loss to describe the basis for the claim, the covered risk that resulted in the loss, the dollar amount of the loss, and the method used to calculate the amount of the loss. See §12.18.

The Fair Claims Settlement Practices Regulations may assist practitioners in preparing the proof of loss. The regulations define "proof of claim" in 10 Cal Code Regs §2695.2(s) as:

> any evidence or documentation in the possession of the insurer, whether as a result of its having been submitted by the claimant or obtained by the insurer in the course of its investigation, that provides any evidence of the claim and that reasonably supports the magnitude or the amount of the claimed loss.

Under the regulations, submission of the proof of claim triggers the insurer's time limits within which it must accept or deny coverage. The regulations do not, however, specify when the "proof of claim" is considered to be complete. The authors are unaware of any authority directly addressing this point. The insured is required only to supply the best information in its possession. See §12.20. Presumably, as soon as the insured has supplied the insurer with all available information and relevant documents, the proof of loss or proof of claim is complete.

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§12.18 C. Use of Experts

The requirement of a written, sworn proof of loss in nearly every title policy compels consideration of the early employment of experts when coverage issues are complex or damages are difficult to assess. Depending on the circumstances, more than one expert may be necessary. Frequently, the adjusters representing title insurance companies are attorneys or in-house coverage experts. Therefore, the insured's attorney may wish to associate coverage counsel or employ a coverage expert. If the value of the claim is problematic, an appraiser, a civil engineer, or a lending expert may be appropriate. The use of experts is discussed more fully in §§13.26-13.32.

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§12.19 D. Responsibilities of Insurer

Insurance regulations require that, on receiving notice of a claim, an insurer must "immediately," but in no event more than 15 calendar days later, provide necessary claim forms, instructions, and reasonable assistance to the insured. 10 Cal Code Regs §2695.5(e)(2). This regulation provides that an insurer need not do so when the first notice of the claim received by the insurer is a "notice of legal action," which is defined in 10 Cal Code Regs §2695.2(o) to mean:

- notice of an action commenced against the insurer with respect to a claim;
- notice of an action against the insured received by the insurer; or
- notice of an action against the principal under a bond.

This definition includes any arbitration proceeding. 10 Cal Code Regs §2695.2(o).

PRACTICE TIP: An argument can be made that 10 Cal Code Regs §2695.5(e) excuses the insurer from providing proof of loss forms and assistance only if the notice of legal action is notice of an action against the insurer. The insured claimant's attorney should, however, request that the insurer provide any required proof of loss forms whenever the attorney initially informs the insurer of any claim, regardless of its nature.

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E. Responsibilities of Insured

§12.20 1. Best Evidence

Under Ins C §552, the insured is required only to give the best evidence in his or her power at the time. At a minimum, the proof of loss should contain enough information to enable the insurer to estimate its rights and liabilities, but what is reasonably necessary to accomplish this task depends on the circumstances in a given case. *Culley v New York Life Ins. Co.* (1945) 27 C2d 187, 192, 163 P2d 698. In *Beasley v Pacific Indem. Co*. (1962) 200 CA2d 207, 210, 19 CR 299, the court excused the insured's failure to produce books and records at an examination because the documents had been destroyed by fire, noting that "only the possible is required."

An insurer may not insist that a claim be proved only through certain types of evidence or that an insured supply every item of information requested by its insurer. *McCormick v Sentinel Life Ins. Co.* (1984) 153 CA3d 1030, 1046, 200 CR 732. An insured's refusal to provide essential information under oath may, however, excuse delay of the coverage decision by the insurer. *Globe Indem. Co. v Superior Court* (1992) 6 CA4th 725, 730, 8 CR2d 251.

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§12.21 2. Misstatements and Omissions

Intentional misstatements or concealment of material facts in a proof of loss or other claim for policy benefits entitle the insurer to rescind the policy. *Claflin v Commonwealth Ins. Co.* (1884) 110 US 81, 94, 28 L Ed 76, 3 S Ct 507; *Cummings v Fire Ins. Exch.* (1988) 202 CA3d 1407, 1419, 249 CR 568; *Kahn v Commercial Union Fire Ins. Co.* (1936) 16 CA2d 42, 45, 60 P2d 177. The materiality of a misstatement or an omission in a proof of loss or other claim for policy benefits is measured by an objective standard, whereas materiality of a misstatement or an omission in an application for insurance is measured by a subjective standard. *Cummings v Fire Ins. Exch.* (1988) 202 CA3d 1407, 1414 n7, 249 CR 568. See §§11.97-11.101.

Further, although innocent misstatements or omissions in an application for insurance will support rescission of the policy (*Imperial Cas. & Indem. Co. v Sogomonian* (1988) 198 CA3d 169, 243 CR 639), only willful misstatements by an insured with knowledge of their falsity in a proof of loss will prevent recovery on the policy (*Claflin v Commonwealth Ins. Co., supra*); *Raulet v Northwestern Nat'l Ins. Co.* (1910) 157 C 213, 236, 107 P 292; *Cummings v Fire Ins. Exch.* (1988) 202 CA3d 1407, 1416, 249 CR 568; *Kahn v Commercial Union Fire Ins. Co., supra*). Case law further indicates that courts are reluctant to declare a forfeiture of a legitimate claim due to technical deficiencies or omissions in the proof of loss, unless there was fraud on the part of the insured. See *Elliano v Assurance Co. of Am.* (1970) 3 CA3d 446, 449, 83 CR 509; *Beasley v Pacific Indem. Co.* (1962) 200 CA2d 207, 209, 19 CR 299.

If the insured was induced to execute a statement in the proof of loss through a false representation by the insurer, the insured is not limited to the amount stated in that proof of loss. *Cook v Lion Fire Ins. Co.* (1885) 67 C 368, 372, 7 P 784.

An erroneous statement in a proof of loss is not conclusive unless the insurer has been prejudiced by the error. Such a false statement is merely evidence to be considered and to be given such weight as appropriate in connection with all the other evidence. *Culley v New York Life Ins. Co.* (1945) 27 C2d 187, 194, 163 P2d 698. Unless there is some basis for estoppel against the insured, the insured may prove a greater loss than he or she originally claimed in a preliminary proof of loss. For example, in *Case v Manufacturers' Fire & Marine Ins. Co.* (1889) 82 C 263, 271, 22 P 1083, the court held that if the insurer:

> has lost no right or advantage by [the insured's] understatement of the amount of his loss, if, in fact, it was understated, there is no reason why he should be denied the right to prove the full amount of the actual loss.

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§12.22 F. Waiver or Estoppel

An insurer may waive or be estopped from requiring proof of loss. For example, if the title insurer denies coverage for the loss, the insurer will be considered to have waived its requirement of a proof of loss. *Lagomarsino v San Jose Abstract & Title Ins. Co.* (1960) 178 CA2d 455, 460, 3 CR 80. See also *Alta Cal. Regional Ctr. v Fremont Indem. Co.* (1994) 25 CA4th 455, 468, 30 CR2d 841, overruled on other grounds in 11 C4th at 34. Insurance Code §553 provides:

> All defects in a notice of loss, or in preliminary proof thereof, which the insured might remedy, and which the insurer omits to specify to him, without unnecessary delay, as grounds of objection, are waived.

Even when the policy requires written notice and proof of loss, if the insurer fails to object to oral notice and fails to inform the insured that written notice and further proof of loss are required, the insurer will be considered to have waived the requirements. *Hall v San Jose Abstract & Title Ins. Co*. (1959) 172 CA2d 421, 426, 342 P2d 362. See also §12.12.

Generally, the theory of waiver is legal in nature, while estoppel is an equitable concept. Although the distinction between the two has been blurred in the past, the California Supreme Court has reaffirmed that they are separate and distinct doctrines. In *Waller v Truck Ins. Exch.* (1995) 11 C4th 1, 31, 44 CR2d 370, the court noted that waiver is the "intentional relinquishment of a known right after knowledge of the facts." The party claiming a waiver bears the burden of proving waiver by "clear and convincing evidence that does not leave the matter to speculation"; "doubtful cases will be decided against a waiver." 11 C4th at 31.

Waiver may be either express (based on the words of the waiving party) or implied (based on conduct indicating an intent to relinquish the right). As noted in *Waller,* estoppel requires proof of the insured's detrimental reliance. 11 C4th at 33. On the doctrines of waiver and estoppel as defenses to the enforceability of terms and conditions of insurance policies, see California Liability Insurance Practice: Claims & Litigation §§5.77-5.81 (Cal CEB 1991).

Under other types of insurance, courts have held that any conduct by the insurer that would lead the claimant to believe that further proof of loss or notice would not be required may result in an implied waiver or estop the insurer to assert the policy provision requiring proof of loss or notice. For example, an insurer's tender of money was held to estop the insurer from denying liability based on failure to provide a proof of loss. *Martin v Postal Union Life Ins. Co.* (1939) 31 CA2d 329, 87 P2d 897 (disability policy). Similarly, an insurer was held to have waived the requirement of a formal proof of loss when the insured notified the insurer's agent the day after the loss and submitted a written estimate within two weeks but the insurer never requested a formal proof of loss. *Elliano v Assurance Co. of Am.* (1970) 3 CA3d 446, 449, 83 CR 509 (fire policy).

An insurer waives any defect in the proof of loss by failing to make prompt objection on that basis. Ins C §554; *National Am. Ins. Co. v Certain Underwriters at Lloyd's of London* (9th Cir 1996) 93 F3d 529, 538.

Statements by adjusters such as "I'll see to it that you get your money" and "Everything will be taken care of" have also led the courts to apply the doctrines of waiver or estoppel. See *Dalzell v Northwestern Mut. Ins. Co.* (1963) 218 CA2d 96, 102, 32 CR 125 (insurer's statement supported jury's finding that insurer waived policy requirement that insured forward summons and complaint to insurer). For the effect of the insurer's failure to promptly object to defects in proof of loss statements, see §12.12. For a comprehensive discussion of the application of the theories of waiver and estoppel to avoid the harsh results of a defective notice of claim or proof of loss, see Liability Ins Prac §8.32.

A right to indemnification under the policy generally cannot be created through waiver or estoppel. As noted in *Manneck v Lawyers Title Ins. Corp.* (1994) 28 CA4th 1294, 1303, 33 CR2d 771:

> The rule is well established that the doctrines of implied waiver and of estoppel, based upon the conduct or action of the insurer, are not available to bring within the coverage of a policy risks not covered by its terms, or risks expressly excluded therefrom, and the application of the doctrines in this respect is therefore to be distinguished from the waiver of, or estoppel to assert, grounds of forfeiture.

See also *Somerset S. Prop. v American Title Ins. Co.* (SD Cal 1994) 873 F Supp 355, 359.

Furthermore, when an insurer denies the tender of defense of third party claims on coverage grounds, a different

analysis applies. An insurer does not automatically waive defenses to coverage that it fails to specify in its denial of the tender, but the insured may establish such a waiver if the insurer's denial manifested an intention to relinquish the unspecified grounds and "induced a reasonable belief" by the insured that the insurer intended to waive these grounds. *Waller v Truck Ins. Exch.* (1995) 11 C4th 1, 34, 44 CR2d 370. See also *Karl v Commonwealth Land Title Ins. Co*. (1997) 60 CA4th 858, 873, 70 CR2d 374 (*Karl II*).

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§12.23 G. Denial of Claim Based on Late or Inadequate Proof of Loss

Condition 5 of the CLTA standard coverage policy provides that if the insurer is prejudiced by an insured's failure to provide the required statement of proof of loss or damage, the insurer's obligations to the insured under the policy 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."

The 1992 ALTA lender's and owner's policies both contain similar language, also located in Condition 5 of those policies. Condition 3(a) of the 1987 Residential policy and the CLTA/ALTA Homeowner's policies states that the insurer's obligation to "you" could be reduced if "your" failure to give prompt notice affects the insurer's ability to dispose of or to defend you against the claim. The 2006 ALTA owner's and lender's policies contain no such language.

In the specific context of title insurance, California courts have held that, to deny coverage based on late notice, the insurer must prove actual prejudice and not just the mere possibility of prejudice. See, *e.g., Moe v Transamerica Title Ins. Co.* (1971) 21 CA3d 289, 302, 98 CR 547. By analogy, the title insurer should be required to prove actual prejudice before denying a claim or terminating the policy based on failure to provide a formal proof of loss. See §11.90. If the insurer denies coverage for the loss on grounds other than late or inadequate proof of loss, the insurer waives its requirement of a proof of loss. See §12.22.

NOTE: The 2006 ALTA owner's and lender's policies removed express language regarding the remedy for the insured claimant's failure to provide a signed proof of loss. It remains to be seen whether case law interpreting other title policies will still be applied in regard to this issue.

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V. INSURER'S DUTY TO INVESTIGATE

§12.24 A. Source of Insurer's Duty to Investigate

When a title insurer receives a notice of claim or a request by an insured to defend an action brought against the insured, the insurer has a duty to investigate the facts underlying the claim or action. This duty is imposed by statute, regulation, and the common law:

- The statutory standards for the investigation of claims are primarily found in the Unfair Practices Act (Ins C §790.03(h)), which requires the insurer to act fairly, promptly, and reasonably in processing claims. These obligations are owed to both the first party insured and the third party claimant. *Travelers Ins. Co. v Lesher* (1986) 187 CA3d 169, 189, 231 CR 791, disapproved on other grounds in *Buss v Superior Court* (1997) 16 C4th at 50 n12, 52 n14. No private right of action exists, however, for either first or third party claimants under Ins C §790.03(h). See §11.29.
- The Fair Claims Settlement Practices Regulations (10 Cal Code Regs §§2695.1-2695.14) were adopted under Ins C §790.03(h) to establish minimum standards for investigation and settlement of claims. The most pertinent provisions provide for establishment and maintenance of claim files (10 Cal Code Regs §2695.3), timely acknowledgment of communications (10 Cal Code Regs §2695.5(a)-(e)(1)), and prompt investigation of claims (10 Cal Code Regs §2695.5(e)(2)-(3)).
- The insurer's duty to investigate is also imposed by the common law standards for good faith and reasonable handling of insurance claims that are incorporated into every policy by operation of law. *Frommoethelydo v Fire Ins. Exch.* (1986) 42 C3d 208, 215, 228 CR 160. See also *Stalberg v Western Title Ins. Co.* (1991) 230 CA3d 1223, 1233, 282 CR 43 (standards for investigation by an insurer applicable under other types of insurance apply to title insurers).

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§12.25 B. Scope of Insurer's Duty to Investigate

The insurer's investigation should at least ascertain whether a covered loss has occurred, as in the case of a first party claim (see *McCormick v Sentinel Life Ins. Co.* (1984) 153 CA3d 1030, 1046, 200 CR 732), or whether a third party claim is potentially insured against so as to determine whether a duty to defend exists (see *Stalberg v Western Title Ins. Co.* (1991) 230 CA3d 1223, 1233, 282 CR 43; *California Shoppers, Inc. v Royal Globe Ins. Co.* (1985) 175 CA3d 1, 37, 221 CR 171).

The parameters of the initial coverage investigation that must be made by an insurer are discussed in a number of appellate court decisions. For example, the supreme court has held that an insurer is obligated to investigate thoroughly the grounds for denying a claim before refusing to pay it. See *Egan v Mutual of Omaha Ins. Co.* (1979) 24 C3d 809, 819, 169 CR 691; *Safeco Title Ins. Co. v Moskopoulos* (1981) 116 CA3d 658, 665, 172 CR 248 (dicta). The implied covenant of good faith and fair dealing requires an insurer to search diligently for evidence supporting the claim and not to ignore available information supporting a basis for coverage. *Mariscal v Old Republic Life Ins. Co.* (1996) 42 CA4th 1617, 1620, 50 CR2d 224. The covenant of good faith and fair dealing also "places the burden on the insurer to seek information relevant to the claim." *Hughes v Blue Cross* (1989) 215 CA3d 832, 846, 263 CR 850.

However, without referring to the level or nature of investigation and after concluding that the terms of a comprehensive general liability policy did not provide coverage for the claims, a court of appeal found that plaintiffs had suffered no harm even if the insurer had been delinquent in investigating or processing the claims. See *McLaughlin v National Union Fire Ins. Co.* (1994) 23 CA4th 1132, 1161, 29 CR2d 559. In *Ticor Title Ins. Co. v Employers Ins.* (1995) 40 CA4th 1699, 1714, 48 CR2d 368, the court concluded that there is no duty on the part of a second-level excess general liability insurer to investigate a third party claim when the duty to defend is obviated by the lack of potential for coverage under the policy terms.

Further, it has been held that the duty to investigate is not a continuing duty; rather, it is the insured's responsibility to call to the insurer's attention new facts that indicate a potential for coverage. See *Gunderson v Fire Ins. Exch.* (1995) 37 CA4th 1106, 1114, 44 CR2d 272. Although an insurer's duties to investigate its insured's claims are "akin to" and may resemble fiduciary duties, an insurer is not required to act as a fiduciary in every instance. *Love v Fire Ins. Exch.* (1990) 221 CA3d 1136, 1148, 271 CR 246.

In *White v Western Title Ins. Co.* (1985) 40 C3d 870, 886, 221 CR 509, the supreme court held that an insurer's duty of good faith continues even after litigation between the insured and insurer is filed. The court noted that a contrary rule would encourage insurers to induce early filing of suits and to delay serious investigation until they would be unencumbered by a duty to deal in good faith. The court also discussed a policy of encouraging prompt investigation.

For further discussion of the authorities governing an insurer's duty to investigate claims, see California Liability Insurance Practice: Claims & Litigation, chap 9 (Cal CEB 1991).

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§12.26 C. Breach of Duty to Investigate

A breach of the insurer's common law duty to investigate claims is actionable in both contract and tort. *Stalberg v Western Title Ins. Co.* (1991) 230 CA3d 1223, 1233, 282 CR 43. See §§11.4-11.37. There is no private right of action, however, for either first or third party claimants for violations of Ins C §790.03(h) and regulations promulgated thereunder. See §11.29.

Constructive notice of a third party claim may trigger the contractual duty to investigate (*California Shoppers, Inc. v Royal Globe Ins. Co.* (1985) 175 CA3d 1, 37, 221 CR 171), but the insurer's failure to do so is not actionable as a breach of the covenant of good faith and fair dealing unless the insurer has actual notice of the claim (175 CA3d at 57). Constructive notice, however, will support a breach of contract action for failure to investigate a third party claim sufficiently to determine the existence of a duty to defend. 175 CA3d at 38. Compare discussions in §§11.4 and 11.16.

An insurer's refusal to conduct a proper investigation of a claim may have other problematic and costly consequences. In *Eigner v Worthington* (1997) 57 CA4th 188, 66 CR2d 808, an insurer that refused to defend a claim without reasonably investigating it was not permitted to set aside a judgment on the claim against the insured on the grounds of surprise or excusable neglect.

Dicta in cases has indicated that, under certain circumstances, an insurer might be liable to its insured for bad faith conduct in its investigation of a claim even if the policy does not provide coverage for the disputed claim. *McMillin Scripps N. Partnership v Royal Ins. Co.* (1993) 19 CA4th 1215, 1222, 23 CR2d 243 (dicta: insurer refuses to disclose to insured results of investigation showing that loss was caused by another of insurer's policyholders, who has liability coverage); *Murray v State Farm Fire & Cas. Co.* (1990) 219 CA3d 58, 65 n5, 268 CR 33 (dicta: insurer unreasonably delays investigation of claim before determining that there is no coverage and insured suffers consequential damages from delay). However, in *Benavides v State Farm Gen. Ins. Co.* (2006) 136 CA4th 1241, 1250, 39 CR3d 650, the appellate court rejected the "extreme circumstances" hypothesized in *Murray* as dicta, and held that there was no tort liability for negligent investigation of a first party insurance claim absent coverage under the policy.

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VI. INSURER'S DUTY TO DEFEND

§12.27 A. Duty to Defend When Potential for Indemnity Exists

The duty to defend against third party claims under a title insurance policy is governed by the same principles that define the duty to defend under general liability policies. *Lambert v Commonwealth Land Title Ins. Co*. (1991) 53 C3d 1072, 1077, 282 CR 445; *Rosen v Nations Title Ins. Co.* (1997) 56 CA4th 1489, 1496, 66 CR2d 714; *Stalberg v Western Title Ins. Co.* (1991) 230 CA3d 1223, 1233, 282 CR 43. Under both title and liability insurance policies, the insurer's duty to defend is triggered whenever there is a potential for indemnity by the insurer at the time the defense is requested. *Israelsky v Title Ins. Co.* (1989) 212 CA3d 611, 620, 261 CR 72; *Stearns v Title Ins. & Trust Co.* (1971) 18 CA3d 162, 167, 95 CR 682.

A carrier owes a broad duty to defend its insured against a lawsuit that seeks damages potentially within the policy coverage. *Scottsdale Ins. Co. v MV Transp.* (2005) 36 C4th 643, 654, 31 CR3d 147; *Blue Ridge Ins. Co. v Jacobsen* (2001) 25 C4th 489, 497, 106 CR2d 535; *Standard Fire Ins. Co. v Spectrum Community Ass'n* (2006) 141 CA4th 1117, 1136, 46 CR3d 804; *American Int'l Specialty Lines Ins. Co. v Continental Cas. Ins. Co*. (2006) 142 CA4th 1342, 1369, 49 CR3d 1. "Implicit in this rule is the principle that the duty to defend is broader than the duty to indemnify; an insurer may owe a duty to defend its insured in an action in which no damages ultimately are awarded." *Montrose Chem. Corp. v Superior Court* (1993) 6 C4th 287, 295, 24 CR2d 467.

In *Foster-Gardner, Inc. v National Union Fire Ins. Co.* (1998) 18 C4th 857, 878, 77 CR2d 107, the court held that a liability policy that stated the insurer would defend the insured "in any suit seeking damages" for harm alleged within the policy was limited to defense of a civil action prosecuted in a court, and did not extend to "claims" or proceedings brought by a governmental agency. The court reasoned that such a proceeding might be a "claim," but it was not a "suit." In the standard title insurance policies, the title insurer's duty to defend is likewise limited to "defense of such insured in litigation in which any third party asserts a claim adverse to the title or interest as insured…." (1990 CLTA Standard Coverage Policy, Condition 4(a); 1992 ALTA Loan Policy, Condition 4(a); 1992 ALTA Owner's Policy, Condition 4(a)); or to "prosecute or defend a court case related to the claim" (1987 ALTA Residential Title Policy, Condition 4(c)). This policy language appears to leave little room for argument that the title insurer has an obligation to defend a "claim" before a lawsuit is filed.

Any doubt about the existence of the defense duty must be resolved in the insured's favor. *Montrose Chem. Corp. v Superior Court* (1993) 6 C4th 287, 299, 24 CR2d 467 (*Montrose I*). *Montrose I* reiterated the principle that the duty to defend (1) rests not on the ultimate adjudication of coverage under the policy but on those facts known by the insurer at the commencement of a third party lawsuit and (2) may exist even if coverage is doubtful and ultimately does not develop. 6 C4th at 295. See also *Century Sur. Co. v Polisso* (2006) 139 CA4th 922, 951, 43 CR3d 468. Furthermore, the defense duty is continuing, "arising on tender of defense and lasting until the underlying lawsuit is concluded" or until it is demonstrated that there is no potential for coverage. 6 C4th at 295. See also *Scottsdale Ins. Co. v MV Transp.* (2005) 36 C4th 643, 655, 31 CR3d 147.

The defendant in *Montrose I* contended that the correct test for determining whether the insurer owes a duty to defend its insured in the underlying action is whether there is a reasonable potential for coverage. The supreme court rejected this argument, noting that it "betrays a fundamental misunderstanding of *Gray* [*v Zurich Ins. Co., supra*]… and of what is at issue in an adjudication of the defense duty." *Montrose Chem. Corp. v Superior Court* (1993) 6 C4th 287, 299, 24 CR2d 467. The court explained (6 C4th at 300):

> Thus, Travelers' advocacy of a "reasonable potential for coverage" standard finds no support in *Gray*. Indeed, in that case we said that "the insurer need not defend if the third party complaint *can by no conceivable theory raise a single issue which could bring it within the policy coverage.*" The quoted language cannot reasonably be understood to refer to anything beyond a bare "potential" or "possibility" of coverage as the trigger of a defense duty. Contrary to Travelers' interpretation, California courts have used the terms "possibility" and "potential" interchangeably, and we see no difference between them.

An unreasonable refusal to defend is actionable as a breach of contract (see §11.4) or breach of the covenant of

good faith and fair dealing (see §11.16). *Campbell v Superior Court* (1996) 44 CA4th 1308, 1319, 52 CR2d 385; *Stalberg v Western Title Ins. Co., supra.* See generally §§11.4-11.37. See also *Eigner v Worthington* (1997) 57 CA4th 188, 66 CR2d 808 (insurer refusing to defend claim without investigation was not permitted to set aside judgment against insured on grounds of surprise or excusable neglect).

PRACTICE TIP: An insurer may choose to defend an insured under a reservation of rights, so that if it is later determined that the policy did not afford coverage of the underlying claim, the insurer may recover its defense costs from the insured. *Scottsdale Ins. Co. v MV Transp.* (2005) 36 C4th 643, 31 CR3d 147. See §12.49.

See also California Liability Insurance Practice: Claims & Litigation, chap 4 (Cal CEB 1991).

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§12.28 1. Comparing Complaint Allegations Against Policy Terms

In *Montrose Chem. Corp. v Superior Court* (1993) 6 C4th 287, 295, 24 CR2d 467, the court affirmed the long-established rule that whether an insurer owes a duty to defend is usually determined "by comparing the allegations of the complaint with the terms of the policy." See also *Scottsdale Ins. Co. v MV Transp.* (2005) 36 C4th 643, 654, 31 CR3d 147; *Kazi v State Farm Fire & Cas. Co.* (2001) 24 C4th 871, 879, 103 CR2d 1. In the context of title insurance, the supreme court also declared that "[w]henever a possible defect in the title is one essential issue in the suit, the action is interpreted as 'founded upon an alleged defect' and the insurer's obligation to represent the insured attaches." See *Paramount Props. Co. v Transamerica Title Ins. Co.* (1970) 1 C3d 562, 571 n7, 83 CR 394. The court considered facts disclosed by the complaint in view of covered defects and exclusions set forth in the policy. 1 C3d at 570.

Although facts pleaded in a complaint against an insured may indicate the potential for coverage when compared to the insuring language of the policy, such facts do not necessarily negate coverage when an exception to coverage is suggested by facts that are in dispute. For example, the basis of the third party suit in *Paramount* (*i.e.,* that the insured allegedly knew of the defect) did not relieve the insurer of its defense duty, even though there was an exclusion from coverage under the policy for defects known to the insured, because the allegation was disputed. 1 C3d at 571. In other words, the courts decline to "designate the third party as the arbiter of the policy's coverage." *Gray v Zurich Ins. Co.* (1966) 65 C2d 263, 276, 54 CR 104. Compare with *Scottsdale Ins. Co. v MV Transp.* (2005) 36 C4th 643, 31 CR3d 147, in which the insurer complied with its defense duty under a reservation of rights, but later properly sought reimbursement of its costs from the insured. On defense under a reservation of rights, see §12.49.

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§12.29 2. Considering Extrinsic Facts

The existence of an insurer's duty to defend is also determined by facts extrinsic to the complaint, including those learned from the insured, legal proceedings, and other available sources. *Jarchow v Transamerica Title Ins. Co*. (1975) 48 CA3d 917, 944, 122 CR 470, overruled on other grounds in 184 CA3d at 434. When such facts demonstrate the possibility that a claim may be covered by the policy, the duty to defend arises. *Scottsdale Ins. Co. v MV Transp.* (2005) 36 C4th 643, 654, 31 CR3d 147; *Waller v Truck Ins. Exch.* (1995) 11 C4th 1, 24, 44 CR2d 370; *Gray v Zurich Ins. Co.* (1966) 65 C2d 263, 276, 54 CR 104.

If, however, the potential for coverage is clearly eliminated by reliable and uncontradicted extrinsic facts, an insurer may properly decline to accept the defense of a third party action whether or not the allegations of the complaint indicate potential liability. *Waller v Truck Ins. Exch.* (1995) 11 C4th 1, 19, 44 CR2d 370; *Stearns v Title Ins. & Trust Co.* (1971) 18 CA3d 162, 167, 95 CR 682. On the insurer's duty to investigate after tender of defense, see §§12.24-12.26.

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§12.30 3. Considering Effect of Potential Amendment to Complaint

An insured is entitled to a defense if the third party complaint alleges the insured's liability for damages potentially covered under the policy or the complaint might be amended to assert liability that would be covered. *Scottsdale Ins. Co. v MV Transp.* (2005) 36 C4th 643, 654, 31 CR3d 147; *Montrose Chem. Corp. v Superior Court* (1993) 6 C4th 287, 299, 24 CR2d 467. In other words, when the facts alleged in the complaint (read alone or with extrinsic facts learned by the insurer from an investigation) reveal that the complaint could be amended to add another theory that would fall within the policy's coverage provisions, the "potential of liability" test has been satisfied and the duty to defend is established. *Gray v Zurich Ins. Co.* (1966) 65 C2d 263, 276, 54 CR 104.

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§12.31 4. Analyzing Effect of Meritless, False, or Fraudulent Claims

Most comprehensive general liability policies expressly provide that the duty to defend arises even when the claims against the insured are meritless, false, or fraudulent. See, *e.g., Gray v Zurich Ins. Co.* (1966) 65 C2d 263, 273, 54 CR 104. The presence of such a clause does not mean, however, that the defense duty is without limits; it applies only to "those actions of the nature and kind covered by the policy." 65 C2d at 274. See §12.32.

Title insurance policies do not contain a "false claims" clause comparable to the one found in general liability policies. Some practitioners believe that this difference requires a different analysis for the scope of, and the principles governing, the duty to defend third party claims against a title policyholder. The underlying rationale for this position is that rights implied in an insurance policy must be closely connected to the express provisions of the policy. *McMillin Scripps N. Partnership v Royal Ins. Co.* (1993) 19 CA4th 1215, 1220, 23 CR2d 243. According to the *McMillin* court (19 CA4th at 1221), the false claims clause in *Gray v Zurich Ins. Co., supra*, gave rise to the implied duty to defend a *potentially* covered third party claim. Some practitioners believe that the absence of a false claims clause in title policies may be the basis for a different standard for the scope of the defense obligations of a title insurer.

The insurer's belief that the insured is not telling the truth about the claim does not necessarily justify the insurer's refusal to defend. *Amato v Mercury Cas. Co.* (1993) 18 CA4th 1784, 1793, 23 CR2d 73 (*Amato I*). In *Amato I,* an automobile policy excluded coverage for bodily injury to insureds, permissive users, and resident relatives of permissive users. Amato, a permissive user of the insured vehicle, caused an accident that injured Sutton, a passenger. Sutton sued Amato, who tendered his defense to the insurer. Although Sutton's residence was contested, the insurer declined Amato's tender of defense on the ground that Sutton was a resident relative. The jury ultimately determined that Sutton was a resident relative. The trial court nonetheless held that the insurer had breached its duty to defend but had not acted in bad faith.

Although declining to hold that information objectively demonstrated to be false creates a duty to defend, the appellate court in *Amato I* held that an insurer who denies coverage based on its uncorroborated belief that the information in its possession may be fabricated does so at its own risk. The insurer was not permitted to vindicate its decision through the use of subsequently discovered evidence or the findings of fact in the underlying action. See §12.28.

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Source: Real Property/California Title Insurance Practice/12 Claims Procedures Under Title Insurance Policies/§12.32 B. Duty Limited to Nature and Kinds of Risks Covered by Policy

§12.32 B. Duty Limited to Nature and Kinds of Risks Covered by Policy

The duty to defend is not unlimited but is measured "by the nature and kinds of risks covered by the policy." *Kazi v State Farm Fire & Cas. Co.* (2001) 24 C4th 871, 880, 103 CR2d 1; *Waller v Truck Ins. Exch.* (1995) 11 C4th 1, 19, 44 CR2d 370. See also *Buss v Superior Court* (1997) 16 C4th 35, 46, 65 CR2d 366. For example, if the policy provides no potential for coverage, the insurer acts properly in denying a defense "even if that duty is later evaluated under case law that did not exist at the time of the defense tender." *Waller v Truck Ins. Exch.* (1995) 11 C4th 1, 26, 44 CR2d 370. When there is no potential for a third party to recover on a covered claim, there is no duty to defend. 11 C4th at 19; *Buss v Superior Court* (1997) 16 C4th 35, 47, 65 CR2d 366.

Under Condition 4(a) of the CLTA policy and of the 1992 ALTA lender's and owner's policies, the title insurer must provide for the insured's defense:

> 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 2006 ALTA owner's and lender's policies similarly state, in Condition 5(a), that the title insurer must provide for the defense of an insured:

> in litigation in which any third party asserts a claim covered by this policy adverse to the Insured. This obligation is limited to only those stated causes of action alleging matters insured against by this policy.

The 1987 Residential policy states that the insurer will defend:

> We will defend your title in any court case as to that part of the case that is based on a Covered Title Risk insured against by this Policy….

The CLTA/ALTA Homeowner's policies similarly state:

> We will defend Your Title in any legal action only as to that part of the action which is based on a Covered Risk and which is not excepted or excluded from coverage in this Policy….

This language prescribes a title insurer's duty to defend. See, *e.g., Havstad v Fidelity Nat'l Title Ins. Co.* (1997) 58 CA4th 654, 68 CR2d 487 (no potential for coverage of action by adjacent landowner challenging easement rights of insured in neighboring parcel); *Rosen v Nations Title Ins. Co.* (1997) 56 CA4th 1489, 66 CR2d 714 (no duty to defend action by bank as junior lienholder against insured lenders; events or changes in condition of title after title policy issued are outside scope of coverage); *Barczewski v Commonwealth Land Title Ins. Co.* (1989) 210 CA3d 406, 413, 258 CR 386 (defense of action by lender against owner for fraud and other torts not required under title policy; fraudulent acts arose from matters outside public record); *Somerset S. Prop. v American Title Ins. Co.* (SD Cal 1994) 873 F Supp 355, 359 (title policy did not cover claim against insured lender for misrepresenting priority of its deed of trust to purchaser of property at trustee sale; hence no duty to defend action by purchaser against lender); *Bailey v State Farm Ins. Co.* (ND Cal 1992) 810 F Supp 267, 270 (no duty to defend action in which adverse decision against insured would not be inconsistent with insured's interest as described in Schedule A of title policy).

Not all disputes over title to property involve title defects. In *Safeco Title Ins. Co. v Moskopoulos* (1981) 116 CA3d 658, 664, 172 CR 248, for example, the insured forced the sale of property in foreclosure to himself by, among other things, filing a lawsuit and recording a lis pendens. A prospective purchaser who did not obtain the property allegedly due to the insured's tortious conduct later sued to rescind the sale to the insured and sought a constructive trust regarding the property. The title insurer then filed a declaratory relief action to establish that it had no duty to defend the action against the insured. The court found that there was no defect in the insured's title and thus no coverage under his title policy. Because the claims against the insured did not fall within the scope of the coverage afforded by the policy, the court held that the title insurer had no duty to defend. 116 CA3d at 666. The prospective purchaser's recording of a subsequent lis pendens also did not trigger the duty to defend. The court found that the effect, if any, of the recording on the marketability of the insured's title occurred after the policy was issued and was not covered. 116

CA3d at 666.

In the following liability insurance cases, the courts affirmed an insurer's rejection of defense of claims outside policy-covered risks:

- *Kazi v State Farm Fire & Cas. Co.* (2001) 24 C4th 871, 879, 103 CR2d 1 (alleged interference with easement did not allege damage to tangible property within policy's coverage for "property damage");
- *Ticor Title Ins. Co. v Employers Ins.* (1995) 40 CA4th 1699, 1707, 48 CR2d 368 (even if third party claim is potentially covered and primary carrier refuses to defend, insured must first exhaust policy limits with primary carrier before excess liability insurer is required to participate in defense);
- *Coit Drapery Cleaners, Inc. v Sequoia Ins. Co.* (1993) 14 CA4th 1595, 1608, 18 CR2d 692 (sexual harassment not covered under general liability policy because of "willful act" exclusion);
- *Devin v United Servs. Auto. Ass'n* (1992) 6 CA4th 1149, 1159, 8 CR2d 263 (injury occurring after homeowner's policy terminated not covered); and
- *Giddings v Industrial Indem. Co.* (1980) 112 CA3d 213, 219, 169 CR 278 (economic losses such as lost profits, loss of good will, and loss of investment not covered as injury to tangible property under general liability policy).

For a more comprehensive discussion of an insurer's duty to defend arising from general liability policies, see California Liability Insurance Practice: Claims & Litigation, chap 4 (Cal CEB 1991).

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§12.33 C. Duty Extends to Entire Action

Generally, an obligation to defend requires an insurer to defend the entire action, even if some of the causes of action are not covered. *Buss v Superior Court* (1997) 16 C4th 35, 65 CR2d 366; *Horace Mann Ins. Co. v Barbara B.* (1993) 4 C4th 1076, 1084, 17 CR2d 210. The 1987 Residential policy states the insurer will defend "that part of the case that is based on a Covered Title Risk insured against by this Policy." The CLTA/ALTA Homeowner's policies state that the insurer will defend "only as to that part of the action which is based on a Covered Risk and which is not excepted or excluded from coverage in this Policy."

Condition 4(a) of the CLTA policy and of the 1992 ALTA policies and Condition 5(a) in the 2006 ALTA policies require a title insurer to defend a third party action only as to "those stated causes of action" alleging a matter covered by the policy. The authors are unaware of any title cases interpreting this provision. Arguably, the policy language could support a title insurer's accepting the defense of only part of a lawsuit and requesting allocation of defense costs accordingly. See, *e.g., Hogan v Midland Nat'l Ins. Co.* (1970) 3 C3d 553, 564, 91 CR 153, disapproved on other grounds in 16 C4th at 56; *Stalberg v Western Title Ins. Co.* (1991) 230 CA3d 1223, 1233, 282 CR 43 (dicta).

Such an interpretation is very unlikely in view of the supreme court's decision on an insurer's duty to defend in *Buss v Superior Court* (1997) 16 C4th 35, 59, 65 CR2d 366 (standard commercial general liability insurer was obligated to defend entire action immediately and could not parse claims). The title policy language, however, would support an action for reimbursement of defense fees for noncovered claims under the standards set forth in the *Buss* opinion (see §12.49 for additional discussion of the opinion). See also §12.27. For further discussion, see California Liability Insurance Practice: Claims & Litigation §§12.13-12.14 (Cal CEB 1991).

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§12.34 D. Duty Arises Immediately

Once triggered, an insurer's duty to defend is "immediate" because the insured has the right to the full protection of a defense on its behalf. *Montrose Chem. Corp. v Superior Court* (1993) 6 C4th 287, 295, 24 CR2d 467. See *Lambert v Commonwealth Land Title Ins. Co.* (1991) 53 C3d 1072, 1077, 282 CR 445 (duty to defend commences on tender of defense); *CNA Cas. v Seaboard Sur. Co.* (1986) 176 CA3d 598, 605, 222 CR 276 (if insurer is obliged to defend, it must do so as soon as possible). An insurer's duty to defend may arise even when the insurer has constructive notice of the claim from a party other than the insured. See *California Shoppers, Inc. v Royal Globe Ins. Co.* (1985) 175 CA3d 1, 37, 221 CR 171, discussed in §12.13.

The duty to defend is measured not at the conclusion of the litigation after all factual disputes have been resolved, but rather by the facts known by the insurer at the inception of the lawsuit. *Montrose Chem. Corp. v Superior Court, supra*; *CNA Cas. v Seaboard Sur. Co.* (1986) 176 CA3d 598, 610, 222 CR 276. Thus, the time for an insurer to investigate and evaluate whether to defend is when the insurer first receives notice of the claim; an insurer may not rely on hindsight to justify its refusal to defend. *B&E Convalescent Ctr. v State Compensation Ins. Fund* (1992) 8 CA4th 78, 92, 9 CR2d 894; *CNA Cas. v Seaboard Sur. Co.* (1986) 176 CA3d 598, 605, 222 CR 276.

In *Mullen v Glens Falls Ins. Co.* (1977) 73 CA3d 163, 173, 140 CR 605, a comprehensive personal liability insurer conducted no investigation before refusing to defend its insured. The trial court found no duty to defend. The issue before the appellate court was whether an insurance company, without investigating the claim, has the right to deny a defense to its insured when the insurer has reason to believe that there is potential liability under the insurance policy but relies on the outcome of the third party action against the insured and subsequent events to justify its denial of defense. The *Mullen* court held (73 CA3d at 173):

> [P]ublic policy alone mandates a negative answer to the question; otherwise, an insurance carrier could refuse to defend its insured on the slightest provocation and then resort to hindsight for the justification. Furthermore, a contrary holding would force the insured to finance his own investigation and the defense of the lawsuit, and then to seek reimbursement in a second lawsuit against the insurance company. This, in turn, could not only impose an undue financial burden on persons who have purchased insurance protection, but it could deprive them of the expertise and resources available to insurance carriers in making prompt and competent investigations as to the merits of lawsuits filed against their insureds.

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VII. INSURER'S TIME LIMITS TO RESPOND TO NOTICE OF CLAIM OR TENDER OF DEFENSE

§12.35 A. Responding to Notice

As indicated in §12.5, notice of the claim triggers the insurer's time deadlines under the California Fair Claims Settlement Practices Regulations. 10 Cal Code Regs §§2695.1-2695.14. These regulations apply to title insurers. 10 Cal Code Regs §2695.1(b).

Receipt of notice of the claim obligates the insurer to acknowledge receipt of the claim, begin investigation, accept or deny the claim, and affirm or deny liability. Upon receiving notice of the claim (unless it is a notice of legal action), the insurer must "immediately," but no more than 15 calendar days later, do the following:

- Acknowledge receipt of the notice, unless payment is made within that time (10 Cal Code Regs §2695.5(e)(1));
- Provide the claimant with necessary forms, instructions, and "reasonable assistance," including but not limited to specifying the information the claimant must provide for proof of claim (10 Cal Code Regs §2695.5(e)(2)); and
- Begin any necessary investigation of the claim (10 Cal Code Regs §2695.5(e)(3)).

See 10 Cal Code Regs §2695.2(s) for the definition of "proof of claim." See discussions in §§12.17, 12.37. See also discussion on "notice of legal action" in §12.19.

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§12.36 B. Investigating the Claim

Under 10 Cal Code Regs §2695.5(e)(3), upon receiving notice of a claim, the insurer must begin any necessary investigation "immediately," but no more than 15 days later, unless the first notice of claim is a notice of legal action. The substantive aspects of the insurer's duty to investigate are discussed in §§11.16, 11.19, 11.23, 11.36, 11.54, 12.24-12.26.

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§12.37 C. Accepting or Denying the Claim

According to 10 Cal Code Regs §2695.7(b), on receiving proof of claim, an insurer must "immediately," but no more than 40 calendar days later, accept or deny the claim, in whole or in part. "Proof of claim" is defined in 10 Cal Code Regs §2695.2(s) to mean:

> any evidence or documentation in the possession of the insurer, whether as a result of its having been submitted by the claimant or obtained by the insurer in the course of its investigation, that provides any evidence of the claim and that reasonably supports the magnitude or the amount of the claimed loss.

Under 10 Cal Code Regs §2695.7(c)(1), if the insurer requires more time to determine whether a claim should be accepted or denied, the insurer must provide the claimant with written notice of the need for additional time. The notice should specify why more time is needed and describe any additional information required to make the determination. If further additional time is needed, the insurer must provide written notice every 30 calendar days until the determination is made or notice of legal action is received. If the determination cannot be made until some event occurs, the insurer must advise the claimant of that situation and estimate when the determination can be made.

While a title insurer is making its determination about whether a timely filed claim is covered, the statute of limitations is equitably tolled. *Forman v Chicago Title Ins. Co.* (1995) 32 CA4th 998, 1001, 38 CR2d 790. See §11.93.

PRACTICE TIP: In processing a title insurance claim, insurers often need an extended period of time to investigate coverage, determine loss (through appraisals and assessments by experts), or attempt to cure the title defect. Maintaining communication with the claimant during this process will result in more cooperation from the claimant during settlement discussions down the road.

Under 10 Cal Code Regs §2695.7(f), no insurer may continue negotiations directly with the claimant for settlement up to the time that the claimant's rights may be affected by a statute of limitations or by an insurance policy or contractual time limit, unless the insurer has given the claimant written notice that the time limit may be expiring and may affect the claimant's rights. Such notice must be given at least 60 days before the date on which the time limit will expire. Section 2695.7(f) does not apply, however, to claimants represented by counsel.

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§12.38 D. Tendering Payment

For first party claims, the insurer must tender payment "immediately" but no more than 30 calendar days after the insurer affirms coverage for the amount of the claim that has been determined and is not in dispute. 10 Cal Code Regs §2695.7(h). For third party claims, the insurer must tender payment "immediately" but no more than 30 calendar days after the insurer affirms coverage and liability for the amount of the claim that has been determined and is not in dispute. 10 Cal Code Regs §2695.7(h).

A title insurer must either tender payment in accordance with these time limits or take actions to resolve the problem giving rise to the claim "immediately upon, but in no event more than 30 days after acceptance of the claim." 10 Cal Code Regs §2695.7(h)(2). These regulations are consistent with Condition 11(b) of the CLTA policy, Condition 11 of the 1992 and 2006 ALTA lender's policies, and Condition 12 of the 1992 and 2006 ALTA owner's policies.

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VIII. RIGHTS AND DUTIES PENDING RESOLUTION OF CLAIM OR TENDER OF DEFENSE

§12.39 A. Insured's Duty of Good Faith and Fair Dealing

Like the insurer, the insured is contractually bound by a duty of good faith and fair dealing. *Commercial Union Assur. Cos. v Safeway Stores, Inc*. (1980) 26 C3d 912, 918, 164 CR 709; *Crisci v Security Ins. Co.* (1967) 66 C2d 425, 429, 58 CR 13. The scope of the insured's duty of good faith, like that of the insurer's, is "dependent upon the nature of the bargain struck between the insurer and the insured and the legitimate expectations of the parties which arise from the contract." *Commercial Union Assur. Cos. v Safeway Stores, Inc., supra*. However, the insured's breach is a breach of contract and not a tort; thus, absent misrepresentation or fraud by the insured, the insured's breach may not be asserted as an affirmative defense to the insured's bad faith action. *Kransco v American Empire Surplus Lines Ins. Co.* (2000) 23 C4th 390, 408, 97 CR2d 151. See §§11.105-11.105B for discussion of the scope of the insured's duties under the implied covenant.

The insured's duty of good faith continues at least until the insurer denies the claim or rejects the tender of defense. During the claims process, the insured's duty of good faith is inextricably bound up with the insured's duty of cooperation. See §12.40.

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§12.40 B. Insured's Duty of Cooperation

Generally, under a title insurance policy an insured must cooperate with the insurer at the inception of a claim by providing timely notice of the claim, promptly tendering defense of any litigation, and complying with any reasonable demand for proof of loss. During the insurer's initial investigation, the insured must comply with reasonable requests such as submitting to a required examination under oath (see §12.42), providing documents related to the claim, and cooperating with the insurer in its efforts to eliminate the title defect or prosecute an action to eliminate the defect. When the insurer accepts the defense of a third party action, the insured must cooperate with the insurer's efforts to defend the action. For further discussion of an insured's duty of cooperation under general liability insurance policies, see California Liability Insurance Practice: Claims & Litigation, chap 11 (Cal CEB 1991).

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§12.41 1. Duty in Third Party Actions

Condition 4(d) of the CLTA standard coverage policy and the 1992 ALTA lender's and owner's policies and Condition 6 of the 2006 ALTA lender's and owner's policies prescribe the insured's duty to cooperate in covered actions by or against third parties in which the insurer in the name of the insured has elected to prosecute or provide a defense. For example, Condition 4(d) of the CLTA policy and the 1992 ALTA lender's policy provides that, when requested to do so, an insured must give the insurer:

> 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 or the lien of the insured mortgage, as insured.

Similar language is found in the 1992 ALTA owner's policy and the 2006 ALTA lender's and owner's policies.

Condition 5 of the 1987 Residential and the CLTA/ALTA Homeowner's policies states, "You must cooperate with us in handling any claim or court case and give us all relevant information."

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§12.42 2. Insurer's Right to Examine Insured Under Oath

The second half of Condition 5 of the CLTA standard coverage policy pertains to the insured's duty of cooperation. On reasonable request, "an insured" must:

- Submit to examination under oath (EUO) by any authorized representative of the insurer;
- Produce for examination, inspection, and copying all records, books, ledgers, checks, correspondence, and memorandums dated before or after the effective date of the policy that reasonably pertain to the loss or damage; and
- Grant written permission for any authorized representative of the insurer to examine, inspect, and copy all records, books, ledgers, checks, correspondence, and memorandums in the custody or control of a third party that reasonably pertain to the loss or damage.

All such information designated as confidential by an insured and provided to the insurer may not be disclosed to others unless, in the insurer's reasonable judgment, disclosure is necessary in the administration of the claim. Similar language is found in Condition 5 of the 1992 ALTA owner's and lender's policies and Condition 6(b) of the 2006 ALTA owner's and lender's policies. The duty to cooperate is addressed in Condition 3(b) in the 1987 Residential policy and the CLTA/ALTA Homeowner's policies.

The ALTA policies refer to "the insured" rather than "an insured." Condition 3(b) in the 1987 Residential policy and the CLTA/ALTA Homeowner's policies requires "you" to make available records that relate to the claim, allow copies of those records to be made, and answer questions about the claim under oath. While the CLTA/ALTA Homeowner's policies define "You" to mean the named insured, "you" is not defined in the 1987 Residential policy.

Because title insurance applies to a specific moment in time rather than a specified policy period, the loss or damage may not become known for many years. Witnesses may become unavailable. Employees may leave with no forwarding address. Documents may become lost or destroyed. Although the insurer's right to conduct an EUO and require production of records is contractual, the insured's duties to cooperate, submit to an EUO, and produce records are all subject to limits of reasonableness. "It is obvious… that only the possible is required." *Beasley v Pacific Indem. Co.* (1962) 200 CA2d 207, 210, 19 CR 299.

The term "examination under oath" is not defined in the CLTA policy or the ALTA policies. In *Globe Indem. Co. v Superior Court* (1992) 6 CA4th 725, 730, 8 CR2d 251, the court described the meaning of this term:

> "Examination" is defined as "(examination of the witness by counsel) [i]nvestigation, questioning, probing, probe, scrutiny, inquiry," in Statsky, West's Legal Thesaurus/Dictionary (West, 1986) at page 291. The word is commonly understood to mean interrogation with questions and answers.

The insurer's right to conduct an EUO and to require the insured to produce documents is so significant that the insured's compliance is a prerequisite to the right to receive policy benefits. *Brizuela v Calfarm Ins. Co.* (2004) 116 CA4th 578, 587, 10 CR3d 661. In *Brizuela,* the court held that (1) the insured's failure to attend the EUO as scheduled by the insurer and failure for six months to propose any alternative dates for the EUO legally constituted a refusal to submit to an EUO; (2) the insurer had no obligation to provide the insured with a copy of the insured's previously recorded statements before the EUO; (3) the insurer was not required to show prejudice before denying policy benefits to an insured who violated a policy provision requiring submission to an EUO; and (4) the availability of a deposition in the bad faith litigation did not excuse the insured's breach of the policy regarding an EUO.

PRACTICE TIP: Although an EUO may not be required in every case, the complex, technical nature of title defects makes the insurer's right to one vitally important. The insurer is entitled to all information supporting the basis of the claim and the amount of the loss. If the insured voluntarily supplies this information early in the claims process, an EUO may not be necessary even though the insurer retains the right to one under the terms of the policy.

In 2001, the Legislature enacted Ins C §2071.1, which codifies certain rights of an insured asked to submit to an

EUO in regard to a claim under a fire or homeowner's policy. This statute states the insured has the following "rights:

- The insurer must notify the insured of its determination to conduct an EUO and provide the insured with a copy of §2071.1;
- The insurer may ask for only information that is relevant and reasonably necessary to process or investigate the claim;
- The EUO may be conducted only on reasonable notice, at a reasonably convenient place, and for a reasonable length of time;
- The insured may be represented by counsel and may record the proceedings in their entirety;
- The insurer must notify the insured that, on request and free of charge, it will provide the insured with a copy of the transcript and a tape, if one exists. The insured may assert any objection that can be made in a deposition under state or federal law.
- If an insured fails to provide an answer to a material question, and, as a result of asserting an objection, that failure prevents the insurer from being able to determine the extent of loss and validity of the claim, the rights of the insured under the contract may be affected. An insured who submits a fraudulent claim may be subject to all criminal and civil penalties applicable under law.

PRACTICE TIP: By its express terms, §2071.1 does not apply to an EUO conducted by a title insurer. There are no reported California cases regarding whether an insured under a title policy should be afforded the "rights" codified in §2071.1. However, cautious insurers may wish to follow the guidelines of §2071.1 to help avoid any argument that their EUOs were conducted in bad faith.

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§12.43 3. Insurer Must Conduct EUO in Good Faith

The right of an insurer to conduct an examination of an insured under oath is governed by principles of good faith and fair dealing. For example, in *Gruenberg v Aetna Ins. Co.* (1973) 9 C3d 566, 108 CR 480, an insurer that had issued a fire policy told an arson investigator that the insured had excessive coverage, suggesting that the insured had committed arson. The insured was subsequently charged with arson and insurance fraud. While the criminal charges were pending, the insurer insisted that the insured submit to an examination under oath and produce certain documents. The insured's attorney told the insurer that he had advised the insured to avoid making any statements while the criminal charges were pending and asked the insurer to waive the requirements of an EUO until the criminal charges were resolved. The insurer refused and ultimately denied liability under the policy because of the insured's failure to submit to the EUO and to produce documents. The insurer's representative appeared at the preliminary hearing on the criminal charges and testified that the insured had excessive fire coverage for his business. After the criminal charges were dismissed, the insured volunteered to submit to an EUO. The insurer again denied coverage based on the insured's prior refusal to appear for the EUO.

The insured then sued for bad faith. As the primary acts of bad faith, the insured alleged that the insurer demanded that the insured submit to an EUO and to produce certain documents "in order to enable [the insurers] to secure further evidence to support the false implication that [the insured] was guilty of arson." Although the appellate court sustained a general demurrer to the bad faith complaint, the supreme court held that "while the complaint is far from a model pleading, it does allege in substance a breach on the part of defendant insurance companies of their duty of good faith and fair dealing…." 9 C3d at 575. The *Gruenberg* court also concluded that the insurer's duty of good faith is unconditional and independent of the performance of the insured's contractual obligations. 9 C3d at 578.

Similarly, in *Tomaselli v Transamerica Ins. Co.* (1994) 25 CA4th 1269, 1281, 31 CR2d 433, the court concluded that the manner in which the insurer conducted an EUO supported an inference of bad faith. In this case, the insureds sued their homeowner's insurer for bad faith after the insurer denied coverage for losses arising from the cracking of the insureds' foundation. The appellate court affirmed the jury's verdict of bad faith based in part on inferences drawn from the insurer's actions in conducting an EUO. The insureds contended and the court agreed that the EUO was merely one means for the insurer to avoid paying the claim, because an EUO is frequently used to investigate fraudulent first party claims. 25 CA4th at 1281.

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C. Breach of Duty of Cooperation

§12.44 1. Grounds for Denial of Coverage or Termination of Policy Benefits

Condition 4(d) of the CLTA standard coverage policy and the 1992 ALTA lender's and owner's policies and Condition 6(a) of the 2006 ALTA lender's and owner's policies provide that if the insurer is prejudiced by an insured's failure to furnish the required cooperation, the insurer's obligations under the policy terminate with respect to the matters requiring the insured's cooperation. Further, Condition 5 of the CLTA policy and both 1992 ALTA policies and Condition 6(b) of both 2006 ALTA policies provide that an insured's failure to submit for examination under oath, produce other reasonably requested information, or grant permission to secure reasonably necessary information from third parties, unless prohibited by law or government regulation, terminate any liability of the insurer for the relevant claim. Conditions 3(a) and 3(b) of the 1987 Residential Policy states that, by failing to cooperate, the insured's obligation under the policy "could be reduced" if that failure affects the insurer's ability to dispose of or defend against the claim. Conditions 3(a)(3) and 3(b)(4) of the CLTA/ALTA Homeowner's policies state that, if the insured fails to cooperate, coverage "will be reduced" if the failure to cooperate affects the insurer's ability to resolve or defend the claim. Condition 5 in the CLTA/ALTA Homeowner's policies provides that if the insured fails to cooperate with the handling of a claim or the defense of a court action, then "coverage will be reduced or ended, but only to the extent Your failure or refusal affects Our ability to resolve the claim or defend You."

NOTE: The ALTA policies refer to "the insured" rather than "an insured" and provide that failure to cooperate under Condition 5 terminates the insurer's liability under the policy "as to that claim" rather than "as to that insured for that claim." An issue may arise as to whether one insured's failure to cooperate terminates the insurer's liability to another insured. Despite these minor differences, the language in the CLTA policy and the ALTA policies should prevent such a result.

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2. Insurer Must Show Prejudice

§12.45 a. Question of Fact or Law

As in the case of breach of a notice provision, before an insurer can deny coverage based on the insured's failure to cooperate, the insurer must prove that it was substantially prejudiced by that breach. *Campbell v Allstate Ins. Co.* (1963) 60 C2d 303, 305, 32 CR 827. See also *American Int'l Specialty Lines Ins. Co. v Continental Cas. Ins. Co*. (2006) 142 CA4th 1342, 1366, 49 CR3d 1. Prejudice is not presumed from the mere fact of breach or delay, even if it results in a default against the insured. 60 C2d at 306.

The issue of prejudice is commonly a question of fact. *Billington v Interinsurance Exch.* (1969) 71 C2d 728, 737, 79 CR 326. Under appropriate circumstances, however, the issue may be established as a matter of law. *Clemmer v Hartford Ins. Co.* (1978) 22 C3d 865, 881, 151 CR 285 (insurer failed to show that it would have successfully defended if insured had tendered defense); *Xebec Dev. Partners, Ltd. v National Union Fire Ins. Co.* (1993) 12 CA4th 501, 532, 15 CR2d 726, disapproved on other grounds in *Essex Ins. Co. v Five Star Dye House, Inc.* (2006) 38 C4th 1252, 1265 n4, 45 CR3d 362 (insured's conduct in stipulating to judgment did not establish substantial prejudice as matter of law), disapproved on other grounds in *Essex Ins. Co. v Five Star Dye House, Inc*. (2006) 38 C4th 1252, 1265 n4, 45 CR3d 362; *Northwestern Title Sec. Co. v Flack* (1970) 6 CA3d 134, 141, 85 CR 693 (insured's filing of declaratory relief action, and thus arguably stipulating to liability, did not establish substantial prejudice as matter of law). These results appear logical because if the insured were in fact liable, stipulating to liability would result in no actual, substantial prejudice to the insurer.

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§12.46 b. Elements of Proof

To establish prejudice, the insurer must at least prove the substantial likelihood that the trier of fact would have found in the insured's favor if the cooperation clause had not been breached. *Billington v Interinsurance Exch.* (1969) 71 C2d 728, 737, 79 CR 326; *Xebec Dev. Partners, Ltd. v National Union Fire Ins. Co.* (1993) 12 CA4th 501, 533, 15 CR2d 726, disapproved on other grounds in *Essex Ins. Co. v Five Star Dye House, Inc.* (2006) 38 C4th 1252, 1265 n4, 45 CR3d 362; *Northwestern Title Sec. Co. v Flack* (1970) 6 CA3d 134, 141, 85 CR 693.

Proving "actual prejudice" from the insured's failure to cooperate is a formidable task. When the insurer intends to rely on breach of the insured's duty to cooperate, the insurer must be prepared to conduct a mini "trial within a trial." The insurer will have to prove not only that critical facts or evidence were lost because the insured failed to cooperate but also that, had such facts or evidence been presented, the outcome of the claim would have been different (*i.e.,* that the insured would have been the prevailing party in the underlying third party claim or that the insurer would have prevailed in the underlying first party claim).

This task places the insurer in a dilemma: How does the insurer know what facts or evidence were lost if the insured fails or refuses to cooperate? Circumstantial evidence can be used to prove such facts or evidence if the insurer possesses such evidence or it becomes available during an underlying third party lawsuit. Such evidence, however, may preclude a finding of actual prejudice in a subsequent action between the insurer and the insured.

EXAMPLE: Assume that an insured's failure to cooperate resulted in the inability to locate a key witness in an underlying third party action being defended by the insurer. The insured subsequently sues the insurer for bad faith. The insurer raises the insured's failure to cooperate as a defense. The fact that a key witness was not available will not by itself establish actual prejudice. The insurer will have to demonstrate that the testimony of the missing witness was sufficiently material to have influenced the outcome of the underlying action in favor of the insured. To accomplish this, the insurer will be required to investigate other sources to demonstrate the content of the testimony that would have been given by the missing witness. The discovery of other sources will be more difficult with the passage of time. If the circumstantial evidence obtained from such sources were admissible and could have served as a substitute for the witness's actual testimony in the underlying third party action, the fact that the insured failed to cooperate might not be determined to be the cause of prejudice to the insurer. Rather, the trier of fact could conclude that actual prejudice, if any, suffered by the insurer was attributable to the insurer's own failure to investigate.

PRACTICE TIP: When an insured fails to cooperate in an underlying third party claim, the insurer's duty to investigate (see §§12.24-12.26) takes on even greater importance. Prompt investigation will not only ensure that the insurer fulfills its duties under the policy despite the insured's lack of cooperation but also arm the insurer with evidence discovered before a subsequent action in which the insurer will bear the burden of proving prejudice from the insured's lack of cooperation.

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§12.47 IX. INSURER'S OPTIONS IN RESPONDING TO NOTICE OF CLAIM OR TENDER OF DEFENSE

Unlike other types of insurance, title policies provide the insurer a wide variety of options in responding to a claim, depending on the facts of the particular claim. The more commonly used options are discussed in §§12.48-12.59. The attorney should keep in mind, however, that this list is not exhaustive. Counsel for both insurer and insured may be able to suggest additional methods acceptable to all parties. If the parties agree, for example, these options may be used in various combinations.

When the claim involves litigation against the insured, the insurer's initial options may be more limited than in first party claims. In addition, the time available for the insurer to investigate the underlying facts and make its decision may be short. Generally, when litigation has commenced against the insured, the insurer has three choices: to defend the insured (see §§12.48-12.50), to reject the insured's tender of defense (see §12.51), or to settle the claim. For discussion of the scope of the insurer's duty to defend, see §§12.27-12.34.

The insurer has more options before litigation has commenced. In addition to the three choices mentioned above, the insurer may take affirmative action to eliminate the defect (see §12.52), prosecute an action to establish title (see §12.53), pay the policy limit (see §§12.54-12.56), purchase the indebtedness (see §12.57), pay the loss or damage (see §12.58), or file a declaratory relief action (see §12.59).

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§12.48 A. Defending the Insured

Whenever a possible defect in title is one essential issue in the suit, the insurer must generally defend. *Paramount Props. Co. v Transamerica Title Ins. Co.* (1970) 1 C3d 562, 571 n7, 83 CR 394. See §§12.27-12.31. The insurer has no duty to defend, however, if the lawsuit against the insured does not involve the nature and kinds of risks covered by the title policy. See §12.32.

On the duty to defend using independent counsel, see California Liability Insurance Practice: Claims & Litigation, chap 13 (Cal CEB 1991).

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§12.49 1. Defending With Reservation of Rights

If the insurer decides to defend the insured, the defense may be provided under a reservation of rights. See *Scottsdale Ins. Co. v MV Transp.* (2005) 36 C4th 643, 656, 31 CR3d 147; *Gray v Zurich Ins. Co.* (1966) 65 C2d 263, 279, 54 CR 104. Under such a reservation, the insurer notifies the insured that it is conducting the investigation or defense of the claim under a reservation of the right to assert policy defenses at a later time. The insured's acceptance of a defense under those conditions is considered to be acquiescence to the reservation of rights. *Blue Ridge Ins. Co. v Jacobsen* (2001) 25 C4th 489, 498, 106 CR2d 535; *Val's Painting & Drywall, Inc. v Allstate Ins. Co.* (1975) 53 CA3d 576, 586, 126 CR 267. Typically, in addition to mentioning specific policy defenses, the reservation of rights will also reserve the insurer's rights to later withdraw its defense of the third party action, to seek a declaratory adjudication of its defense or indemnity obligations, or both, and to seek reimbursement of defense fees and costs.

When an insurer defends a lawsuit against the insured containing "mixed" causes of action, generally the insurer must defend the entire action and seek reimbursement for noncovered claims later. See §12.33. The right to reimbursement of defense fees for those claims potentially covered by the policy cannot be created unilaterally by simply making a reservation of rights. Such a right is not implied in law, but can be created only by express policy language or an agreement with the insured supported by new consideration. *Buss v Superior Court* (1997) 16 C4th 35, 49, 65 CR2d 366; but see *Westchester Fire Ins. Co. v Wallerich* (8th Cir 2009) 563 F3d 707, 714 (criticizing Buss holding). An insurer does have an implied in law right to reimbursement of defense fees that can be allocated solely to claims that are "not even potentially covered," because the insurer has no contractual duty to defend noncovered claims, even when they are combined in an action with potentially covered claims. 16 C4th at 50. See also *Scottsdale Ins. Co. v MV Transp.* (2005) 36 C4th 643, 658, 31 CR3d 147. To obtain reimbursement of any defense fees for noncovered claims, the insurer has the burden of proving by a preponderance of the evidence that the fees were fairly and reasonably allocable solely to the noncovered claims. 16 C4th at 53. See 19 CEB Civ Litigation Rep 206 (Aug. 1997).

Unlike the cases in which the failure to mention policy provisions will not limit or defeat coverage, there is ample authority indicating that if the insurer neglects to reserve the right to seek reimbursement of the defense costs, the right of reimbursement is waived. See *Golden Eagle Ins. Co. v Foremost Ins. Co.* (1993) 20 CA4th 1372, 1391, 25 CR2d 242; *American Motorists Ins. Co. v Allied-Sysco Food Servs., Inc.* (1993) 19 CA4th 1342, 1355, 24 CR2d 106, disapproved on other grounds in *Buss v Superior Court* (1997) 16 C4th 35, 50 n12, 65 CR2d 366; *Val's Painting & Drywall, Inc. v Allstate Ins. Co.* (1975) 53 CA3d 576, 588, 126 CR 267.

Because of the complex nature of title defects, defense under a reservation of rights is common. See *Native Sun Inv. Group v Ticor Title Ins. Co.* (1987) 189 CA3d 1265, 1276, 235 CR 34; *Safeco Title Ins. Co. v Moskopoulos* (1981) 116 CA3d 658, 172 CR 248.

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§12.50 2. Providing Independent Counsel

A title insurer should carefully consider whether a reservation of rights is necessary, particularly if that reservation may create a conflict of interest that entitles the insured to independent or *Cumis* counsel. See *Israelsky v Title Ins. Co.* (1989) 212 CA3d 611, 619 n6, 261 CR 72; *San Diego Fed. Credit Union v Cumis Ins. Soc'y* (1984) 162 CA3d 358, 375, 208 CR 494 (dicta). The insurer's obligation to provide independent counsel has now been codified in CC §2860. See *DeriviConstr. & Architecture, Inc. v Wong* (2004) 118 CA4th 1268, 14 CR3d 329 (noting that *San Diego Fed. Credit Union v Cumis Ins. Soc'y* was superseded by CC §2860). Civil Code §2860 provides, among other things:

- That independent counsel must be provided when the policy includes a duty to defend and a conflict of interest arises that by statute creates the right to independent counsel (CC §2860(a)).
- That the right to independent counsel may be waived if the appropriate language is used (CC §2860(e)).
- That the policy may specify a process for selecting independent counsel consistent with the statute (CC §2860(a)).
- That statutory grounds (CC §2860(b)) for an insured's right to independent counsel:
- May arise when an insurer reserves its rights on an issue, the outcome of which is in the control of defense counsel first retained by the insurer.
- Do *not* arise (a) with respect to allegations or facts for which the insurer has denied coverage or allegations of punitive damages or (b) solely because an insured is sued for an amount exceeding the policy limits.
- The right of the insurer to require that counsel selected by the insured is qualified and has malpractice insurance (CC §2860(c)).
- The obligation of the insurer to pay the fees of the independent counsel and binding arbitration to resolve fee disputes (CC §2860(c)).
- The obligation of both the insured and independent counsel to disclose all relevant, nonprivileged information to the insurer (CC §2860(d)).
- The obligations of the insured and of both insurer-retained defense counsel and independent counsel to cooperate (CC §2860(f)).

As indicated in CC §2860(b), not every reservation of rights by the insurer creates a conflict of interest requiring appointment of independent counsel for the insured. If coverage is determined by an issue that is independent of the issues involved in the underlying case, no conflict of interest exists that would require the appointment of independent counsel. *Blanchard v State Farm Fire & Cas. Co.* (1991) 2 CA4th 345, 350, 2 CR2d 884.

In *James 3 Corp. v Truck Ins. Exch.* (2001) 91 CA4th 1093, 111 CR2d 181, the court laid out some of the situations that may create a conflict of interest requiring appointment of independent counsel. Independent counsel may be required if:

- The insurer reserves its rights on a given issue and the outcome of that coverage issue can be controlled by the insurer's retained counsel;
- The insurer insures both the plaintiff and the defendant;
- The insurer has filed suit against the insured, whether or not the suit is related to the lawsuit the insurer is obligated to defend;
- The insurer pursues settlement in excess of policy limits without the insured's consent and leaving the insured exposed to claims by third parties; and
- Any other situation in which an attorney who represents the interests of both the insurer and the insured finds that the representation of one is rendered less effective by reason of the representation of the other.

In addition, the *James 3 Corp.* court held that the following does not give rise to a conflict of interest:

- The insurer's refusal to prosecute affirmative defenses when the insurer has agreed to defend the insured as to the plaintiff's claims without a reservation of rights;

- The insurer's refusal to prosecute cross-claims for affirmative relief;
- The insurer's reservation of rights to seek reimbursement of defense costs allocable to noncovered claims [a *Buss* reservation, *Buss v Superior Court* (1997) 16 C4th 35, 51, 65 CR2d 366].

EXAMPLE: In *Native Sun Inv. Group v Ticor Title Ins. Co.* (1987) 189 CA3d 1265, 1276, 235 CR 34, the state asserted *Gion-Dietz* rights in the insured's property. (In *Gion v City of Santa Cruz* (1970) and *Dietz v King* (1970), considered together in 2 C3d 29, 43, 84 CR 162, the California Supreme Court implied public dedication of property rights as a result of historic public use, a holding largely abrogated prospectively by CC §1009; see *Friends of the Trails v Blasius* (2000) 78 CA4th 810, 93 CR2d 193.) The title insurer reached an agreement with the insured to prosecute a quiet title action against the state as a means of clearing the insured's title. However, the insurer reserved the rights to later assert that the *Gion-Dietz* claims were not covered by the title policy. After settling the quiet title action, the insured sued the insurer, alleging in part that the insured was entitled to recover attorney fees incurred by the counsel it had retained in the quiet title action. Noting that coverage for the *Gion-Dietz* claims turned solely on interpretation of the title policy (rather than the insured's conduct) and that the quiet title action did not place at issue any rule of law or fact that would bear on the interpretation of the title policy, the court concluded that there was no conflict of interest and that the insured was not entitled to independent or *Cumis* counsel.

See California Liability Insurance Practice: Claims & Litigation, chap 13 (Cal CEB 1991) for further discussion of the defense of an action with the participation of independent counsel when there is a conflict of interest between an insurer and an insured.

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§12.51 B. Rejecting Tender of Defense

If the insurer decides to decline the tender of defense, it must do so in writing. 10 Cal Code Regs §2695.7(b)(1). Unlike the regulations governing the denial of a first party claim, those governing the rejection of a tender of defense do not specifically require the insurer to refer to specific policy provisions, conditions, or exclusions or the factual basis of these items. Further, when the insurer denies coverage on one ground, the insurer does not automatically waive other policy defenses not specifically stated in the denial, absent clear and convincing evidence of the insurer's intent to waive such defenses. *Waller v Truck Ins. Exch.* (1995) 11 C4th 1, 31, 44 CR2d 370, disapproving *Alta Cal. Regional Ctr. v Fremont Indem. Co.* (1994) 25 CA4th 455, 466, 30 CR2d 841, to the extent that the court adopted a rule of automatic waiver.

PRACTICE TIP: The insured's attorney should politely insist that the insurer specify which policy provisions, conditions, or exclusions apply to the facts of the claim. Clear communication between counsel for the insured and the insurer may convince the insured that the insurer is correct or may reveal omissions or mistaken assumptions by the insurer that would provide the insured with an appropriate basis to request that the insurer reconsider its denial. It may also be appropriate for the insured to engage the assistance of experts to strengthen its request for reconsideration or determine whether the insured has a chance to succeed in an action for declaratory relief on the coverage issues. On the use of experts in coverage litigation, see §§13.26-13.32.

If the lawsuit against the insured does not involve the nature and kinds of risks covered by the title policy, the insurer has no duty to defend. See §12.32.

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§12.52 C. Eliminating the Defect

Condition 4(b) of the CLTA standard coverage policy (and similar language in Condition 4(b) of the 1992 ALTA lender's and owner's policies and Condition 5(b) of the 2006 ALTA lender's and owner's policies, and comparable provisions in Conditions 4(c) and 4(e) of the 1987 Residential policy and Conditions 4(a)(3) and 4(a)(8) of the CLTA/ALTA Homeowner's policies) authorizes the insurer to take action to eliminate the defect in title:

> 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 or the lien of the insured mortgage, as insured, or to prevent or reduce loss or damage to an 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.

Condition 4(b) requires the insurer to act "diligently." Condition 8(a) of the CLTA policy and the 1992 ALTA lender's policy and Condition 9(a) of the 1992 ALTA owner's policy and both 2006 ALTA policies provide that if the insurer eliminates the defect in a "reasonably diligent manner," the insurer's liability for loss or damage under the policy is terminated, and its obligations with respect to the defect are discharged. Similarly, Condition 6 of the 1987 Residential policy and the CLTA/ALTA Homeowner's policies requires the insurer to remove the defect "within a reasonable time," or "with reasonable diligence." The determination of what constitutes reasonable diligence is a question of fact that depends on the situation of the parties, the nature of the transaction, and the facts of the particular case. *Nebo, Inc. v Transamerica Title Ins. Co.* (1971) 21 CA3d 222, 228, 98 CR 237.

EXAMPLE: In *Nebo*, the buyer, Nebo, entered into an exchange agreement for 17 improved lots with Sacramento Savings, which claimed title as the purchaser at a trustee's sale. A preliminary title report, however, showed title to the four lots vested in the Jones Group. Before the escrow with Nebo opened, Sacramento Savings lost a quiet title action regarding the remaining 13 lots, which had identical title problems. An appeal of this decision was pending. Neither the quiet title action nor the pending appeal were disclosed to Nebo. With full knowledge of the title defect and pending litigation, Transamerica stated that it was willing to issue a policy of title insurance on the transfer to Nebo because it had previously insured Sacramento Savings' title to the four lots. After the close of escrow, tenants on the four lots refused to pay their rent to Nebo and instead paid it to the Jones Group. This caused financial hardship to Nebo, which was brought to the attention of Transamerica on numerous occasions. The title policy required the insurer to take action to eliminate a covered defect. On demand by Nebo, Transamerica agreed to clear title to the four lots but decided to await resolution of the appeal of the quiet title action regarding the other 13 lots. While the appeal was pending, Nebo made mortgage payments on the property and the Jones Group continued to collect the rent. When the court of appeal affirmed the quiet title judgment, Transamerica purchased the four lots in question from the Jones Group and delivered clear title to Nebo almost 3½ years after Nebo's escrow had closed. In a subsequent action by Nebo against Transamerica, the appellate court affirmed the trial court's determination that Transamerica had not perfected Nebo's title within a reasonable time because of financial hardship imposed on Nebo in continuing to make payments on the property while not receiving rent.

PRACTICE TIP: The insurer's attorney should carefully consider whether there is ongoing, accumulating damage to the insured resulting from a covered title defect. The *Nebo* court noted that the insurer had "gambled on litigation and lost." 21 CA3d at 229. Although the language of the current standard coverage policy no longer requires the insurer to cure a title defect on demand, if the insurer chooses that option, the policy language still requires the insurer to act diligently. See Condition 4(b). In determining whether the insurer acted reasonably or diligently, a court should not solely rely on whether the insurer's efforts were successful. The key fact in *Nebo* appears to be the financial hardship to the insured resulting from its inability to collect rent on the four lots. The mere fact that Nebo was required to make payments on the property should be irrelevant, because Nebo would have had to

make those payments in any event. If Nebo had received the rents or Transamerica had advanced an equivalent sum to Nebo during the appeal (subject to a right of repayment following a successful appeal), the court's ruling in *Nebo* might have been different.

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§12.53 D. Prosecuting Action to Establish Title

Condition 4(b) of the CLTA standard coverage policy and the 1992 ALTA lender's and owner's policies and Condition 5(b) of the 2006 ALTA lender's and owner's policies (referred to in §12.52) authorize the insurer to prosecute any lawsuit or proceeding that, in the opinion of the insurer, may be necessary or desirable to establish title, as insured, to the estate or interest or the lien of the insured mortgage. Likewise, Condition 4(c) of the 1987 Residential policy and Condition 4(a)(3) of the CLTA/ALTA Homeowner's policies authorize the insurer to prosecute a court case related to the claim.

Under this provision, the insurer may undertake legal action to eliminate the defect or perfect the insured's title. Instead, the insurer may choose, *e.g.,* to give the insured monetary compensation resulting from the title defect. See §12.54. If legal action is pursued, it may take the form of, inter alia, a quiet title action, a declaratory relief action, or an action in probate court for a declaration regarding the interpretation of a trust or will.

EXAMPLE: In *Jarchow v Transamerica Title Ins. Co.* (1975) 48 CA3d 917, 941, 122 CR 470, overruled on other grounds in 184 CA3d at 434, the insurer issued a policy that failed to exclude an easement. The policy language required the insurer to quiet title on behalf of the insured. On demand by the insured, the title company refused to commence an action to quiet title, so the insured filed the action. The court held that the insurer had breached its duty to commence an action to remove the cloud on the insured's title and therefore was liable for the insured's damages resulting from its failure to act.

PRACTICE TIP: More recently issued policies no longer require the title insurer to eliminate the defect on demand, because this is now the insurer's choice. As noted in §12.52, however, if the insurer elects to prosecute an action to eliminate the defect, the policy language still requires that the insurer "shall do so diligently." *Nebo, Inc. v Transamerica Title Ins. Co.* (1971) 21 CA3d 222, 228, 98 CR 237.

The insurer's obligation to prosecute an action or to eliminate title defects with diligence is limited to defects that are covered by the title policy. For example, in *Manneck v Lawyers Title Ins. Corp.* (1994) 28 CA4th 1294, 33 CR2d 771, the insured homeowners discovered that virtually everything outside their back door, including their swimming pool, deck, and pool equipment, was constructed on adjoining property owned by a neighbor. The title policy at issue was an earlier version of the ALTA owner's residential policy (ALTA-R). The policy also defined "Covered Title Risks" to include forced removal of existing structures other than a boundary wall or fence if the structure extended onto adjoining land ("forced removal coverage"). Although the neighboring landowner planned to develop his property, the neighbor took no action to develop the property nor did he demand removal of the insured's swimming pool, deck, or related equipment.

The insureds in *Manneck* demanded that the title insurer immediately institute legal action regarding the improvements. The insurer took the position that because there was no pending action to force removal of the improvements, coverage under the title policy had not been triggered. The insureds then sued for bad faith. The insureds argued that it is the insurer's duty to act when the potential for the occurrence of a covered risk becomes known and that the "forced removal coverage" was triggered even before the covered defect became a reality by a forced removal of the insured's structures. The appellate court rejected these arguments, holding that nothing in the policy or applicable case law required the insurer to act when made aware of the mere potential, rather than the present existence, of the forced removal of the plaintiff's improvements.

PRACTICE TIP: The policy in *Manneck* was an earlier version of an ALTA residential form. The *Manneck* decision does not refer to any specific language in that policy that obligated the insurer to take legal action to eliminate a title defect. Thus, *Manneck* may be quite narrow and limited to ALTA-R policies with little or no application outside the "forced removal" context.

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§12.54 E. Paying the Policy Limit

Condition 6(a)(i) of the CLTA standard coverage policy and the 1992 ALTA lender's and owner's policies and Condition 7(a) of the 2006 ALTA lender's and owner's policies authorize the insurer to pay the policy limit plus any costs and attorney fees and expenses incurred to eliminate any further liability under the policy. Similarly, Conditions 4(a), 4(b), and 4(d) of the 1987 Residential policy and the CLTA/ALTA Homeowner's policies authorize the insurer to pay the claim, negotiate a settlement, or pay the amount required by the policy. Condition 4(f) of the 1987 Residential policy authorizes the insurer to cancel the policy by paying the policy limit then in force, plus attorney fees and expenses incurred up to that time. Conditions 4(a)(5), 4(a)(6), and 4(a)(7) of the CLTA/ALTA Homeowner's policies authorize the insurer to "end the coverage" of the policy by paying the actual loss, or specified policy limits for certain covered risks, plus costs and attorney fees and expenses incurred up to that time.

The policies indicate that once the insurer exercises the option to pay the actual loss or applicable policy limit, all liability and obligations to the insured under the policy (other than to make the required payment) terminate, including any liability to defend, prosecute, or continue any litigation. All these policies except the 2006 ALTA lender's and owner's policies provide for cancellation or require that the policy be surrendered to the insurer for cancellation.

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§12.55 1. When Litigation Pending Against Insured

Although there is no direct authority on point, it is doubtful that this provision could be invoked to terminate a defense duty when there is pending litigation against the insured. For example, in cases interpreting an insurer's duty to defend under general liability policies, courts have held that the insurer cannot "artificially exhaust" its policy limits to effectively abandon the insured in midcourse or "walk away from its duty to defend its insured by tendering its policy limits" while litigation against the insured is pending. See, *e.g., Johnson v Continental Ins. Co.* (1988) 202 CA3d 477, 483, 248 CR 412. If, however, the insurer "reasonably" exhausts its policy limits by, *e.g.,* settling one or more suits before another is filed, the insurer's defense obligation will be terminated for the suit not filed before the policy limits were exhausted. 202 CA3d at 485. For further discussion of tendering the policy limits as a defensive strategy, see §11.88.

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§12.56 2. When Insurer Acting in Dual Capacity

The option to pay the policy limit as a method of discharging the insurer's liability may be available only to a title insurance company when it is acting within its capacity as an insurer. For example, title companies frequently provide escrow services in real estate transactions. An escrow agent owes limited fiduciary obligations to the parties to escrow, which continue at least until the escrow is closed under the escrow instructions. See *Summit Fin. Holdings, Ltd. v Continental Lawyers Title Co.* (2002) 27 C4th 705, 711, 117 CR2d 541; *Claussen v First Am. Title Guar. Co.* (1986) 186 CA3d 429, 435, 230 CR 749. See also discussion in §11.47.

When a title insurer also acts as escrow agent, the insurer will face potential liability for, among other things, breach of fiduciary duty in its capacity as the escrow agent. If title to the insured property fails to vest in the insured due to an error by the insurer in its capacity as the escrow agent, an argument can be made that, as the escrow agent, the insurer must take action to quiet title on the insured's behalf.

This argument raises an interesting question: If the insurer also acted as escrow agent in the transaction, does the insurer's potential liability as the escrow agent foreclose the insurer's option of simply paying the policy limit? In other words, does the insurer's separate liability as the escrow agent require the insurer to prosecute an action to quiet title?

Although the authors are not aware of any authority directly on that point, it appears that the insurer's dual capacity would not result in the application of a remedy (found only in the insurance contract) to a breach of duty while the insurer is acting in its capacity as an escrow holder. See *Stalberg v Western Title Ins. Co.* (1994) 27 CA4th 925, 931, 32 CR2d 750 (representations made by title company in its capacity as insurer could not be used as basis for estoppel in cause of action for slander of title based on escrow malfeasance). Counsel for both parties should consider this factor, however, if the insurer also acted as the escrow agent and title failed to pass to the insured as required because of the insurer's failure to follow the escrow instructions. See also §11.48.

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§12.57 F. Purchasing the Indebtedness

Condition 6(a)(ii) of the CLTA standard coverage policy and the 1992 ALTA lender's policy and Condition 7(a)(ii) of the 2006 ALTA lender's policy authorize the insurer to purchase an insured lender's indebtedness (plus any costs, attorney fees, and expenses) and thus terminate liability under the policy. This provision does not apply to the 1992 or 2006 ALTA owner's policy, the 1987 Residential policy, or the CLTA/ALTA Homeowner's policies.

NOTE: The accrual date of claims arising from insured loans has been the subject of reported cases. See §§11.10-11.14.

Once the insurer exercises this option, all liability and obligations to the lender under the policy (other than to make the required payment) terminate, including any liability or obligation to defend, prosecute, or continue any litigation. Under the CLTA and the 1992 ALTA lender's policies, the policy must be surrendered to the insurer for cancellation. That requirement has been removed in the 2006 ALTA lender's policy.

PRACTICE TIP: Although there is no direct authority on point, the authors doubt that the insurer could terminate its defense obligation under this provision when litigation is pending against the insured lender, unless the pending action is resolved concurrently. See §12.55.

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§12.58 G. Paying Loss or Damage

The insurer is authorized to pay or otherwise settle with the insured claimant the loss or damage covered by the policy or to pay or otherwise settle with other parties any claim insured under the policy. See Condition 6(b) of the CLTA standard coverage policy:

> (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.

Condition 6(b) of the 1992 ALTA lender's and owner's policies, Condition 7(b) of the 2006 ALTA lender's and owner's policies, Conditions 4(a) and 4(d) of the 1987 Residential Policy, and Condition 4(a) of the CLTA/ALTA Homeowner's policies contain substantially similar language.

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§12.58A H. Payment Under Reservation of Rights

If certain circumstances exist, the insurer may recover settlement payments made under a reservation of rights, even over the insured's objections, if it is later determined that the underlying claims were not covered. However, for such recovery to be possible, the insurer must:

- Timely and expressly reserve its right to seek such recovery;
- Give express notice to the insured of the insurer's intent to accept the proposed settlement offer; and
- Expressly offer to the insureds the chance to assume their own defense when the insured and the insurer disagree whether to accept the proposed settlement.

Blue Ridge Ins. Co. v Jacobsen (2001) 25 C4th 489, 497, 106 CR2d 535.

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§12.59 I. Filing Declaratory Relief Action

If the insurer believes that the defect is not covered by the title policy, it may file a declaratory relief action to determine coverage. If the title insurer files a declaratory relief action before the insured files an action for breach of contract or bad faith, the insured's subsequent action for breach of contract or bad faith should be abated until the declaratory relief action is resolved. *Lawyers Title Ins. Corp. v Superior Court* (1984) 151 CA3d 455, 460, 199 CR 1.

Although the filing of a declaratory relief action will not eliminate the insurer's potential liability for bad faith, it may help to mitigate any bad faith exposure. In fact, the insurer may agree to a declaratory relief action to determine coverage, particularly if an agreement can be reached that the declaratory relief action may be determined on stipulated facts or a limited record, thus providing an efficient and economical presentation of the declaratory relief action.

If the claim involves litigation against the insured, the insurer may agree to defend the insured under a reservation of rights (including the right to withdraw the defense or to seek reimbursement of defense costs) and file a declaratory relief action to determine coverage and the extent of the duty to defend. See *Safeco Title Ins. Co. v Moskopoulos* (1981) 116 CA3d 658, 663, 172 CR 248. To prevail in the action, the insurer must establish the absence of any potential coverage, while the insured need only show that the defect may fall within the policy coverage. *Truck Ins. Exch. v Bennett* (1997) 53 CA4th 75, 81, 61 CR2d 497. See §§12.27-12.34.

The insured may, however, obtain a stay of the declaratory relief action when the coverage question turns on facts to be litigated in the underlying action. In *Montrose Chem. Corp. v Superior Court* (1993) 6 C4th 287, 301, 24 CR2d 467, the supreme court summarized the general principles to be applied when a declaratory relief action is brought to determine coverage issues while the underlying claim on which the coverage dispute centers is still pending:

> To eliminate the risk of inconsistent factual determinations that could prejudice the insured, a stay of the declaratory relief action pending resolution of the third-party suit is appropriate when the coverage question turns on facts to be litigated in the underlying action. [Citations.] For example, when the third party seeks damages on account of the insured's negligence, and the insurer seeks to avoid providing a defense by arguing that its insured harmed the third party by intentional conduct, the potential that the insurer's proof will prejudice its insured in the underlying litigation is obvious. This is the classic situation in which the declaratory relief action should be stayed. By contrast, when the coverage question is logically unrelated to the issues of consequence in the underlying case, the declaratory relief action may properly proceed to judgment.

See also *Kleis v Superior Court* (1995) 37 CA4th 1035, 1051, 44 CR2d 181 (stay of declaratory relief action); *Haskel, Inc. v Superior Court* (1995) 33 CA4th 963, 978, 39 CR2d 520 (stay of discovery in declaratory relief action). Actions for declaratory relief are also discussed in §§11.15, 13.36. For further discussion of the use of actions for declaratory relief to resolve coverage questions, see California Liability Insurance Practice: Claims & Litigation, chap 20 (Cal CEB 1991).

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Litigation Strategies and Procedures

Charles A. Hansen

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§13.1 I. INTRODUCTION AND SOURCES OF LAW

This chapter highlights the procedural and strategic issues presented by title insurance lawsuits. Although land title and title insurance cases often involve unique issues of substantive real property or insurance law, they are, from a procedural standpoint, fairly conventional examples of California civil litigation. The vast majority are tried either in arbitration (see chap 14 and §13.12) or in California superior courts, in light of the amount typically in dispute and the usual absence of a federal question or diversity basis for federal district court jurisdiction. The California Code of Civil Procedure and the California Evidence Code are consequently the primary sources of procedural and evidentiary law in title insurance cases.

On procedural issues, and for a wide range of civil procedure forms, see generally California Civil Procedure Before Trial (4th ed Cal CEB 2004).

Reported cases involving types of insurance other than title insurance are generally appropriate sources of guidance and authority when no directly relevant title insurance cases can be found. See, *e.g., Rosen v Nations Title Ins. Co.* (1997) 56 CA4th 1489, 1496, 66 CR2d 714; §§11.4, 11.16-11.27, 12.24-12.25, 12.27-12.46.

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§13.2 II. WHEN TO COMMENCE A TITLE INSURANCE LAWSUIT

Title insurance litigation is generally preceded by a claims process, during which the title insurer is obligated to make a thorough and good faith investigation. *Mariscal v Old Republic Life Ins. Co.* (1996) 42 CA4th 1617, 1624, 50 CR2d 224. See §12.25. During this investigation, the insurer has a right under the policy to examine the insured under oath in a manner that can amount to a prefiling deposition. See §12.42. Further, the insurer has a right to review and copy any records pertinent to the claim. Prompt disposition of claims is required by California's Fair Claims Settlement Practices Regulations (10 Cal Code Regs §§2695.1-2695.14) (effective Jan. 14, 1993). See §§12.35-12.38. It is usually a mistake for either the carrier or the insured to commence litigation before the investigation is concluded by acceptance or denial of the claim.

From the claimant's standpoint, premature litigation can confuse or obscure potential bad faith claims and give the insurer a plausible defense that the insured did not meet the duty of cooperation or allow the claims process an adequate opportunity to resolve the dispute. See cases discussed in §§11.104-11.105. This is particularly true when the claim involves complex chain of title or priority issues, which may require extensive investigation.

Premature litigation by the insurer can be perceived as a heavy-handed tactic and as indicative of an insurer's acting in bad faith and being more focused on furthering its own interests than protecting the rights of its insured.

PRACTICE TIP: Counsel for the insured will, absent unusual circumstances, want to receive a final denial of coverage before commencing a lawsuit. Even when a denial letter has been received, an effort should be made to seek the insurer's reconsideration of any obvious mistakes or omissions in the rejection letter. It is important for insured's counsel not to pounce on honest mistakes by the insurer as evidence of bad faith, because this approach often hardens positions, delays settlement, and creates unrealistic expectations in the insured.

The insurer should never initiate litigation without having paid the insured any amount the insurer acknowledges to be due. An insurer is not entitled, under the policy or otherwise, to withhold any benefits that are obviously due and payable.

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III. COUNSELING THE INSURED

§13.3 A. Review and Assess Client's Expectations

Unlike typically litigation-savvy insurers, an insured in a title insurance case is often unfamiliar with the legal system and may have highly unrealistic expectations about the outcome of the case. It is crucial that counsel address these matters before a lawsuit is filed and substantial litigation expenses are incurred in order to avoid unwelcome surprises to the client and lawsuits that seem to take on a life of their own. While discussion and exploration of insurance bad faith and third party tort theories is often appropriate, care must be taken to explain to the client that major bad faith and punitive damages awards are relatively rare and that the client's frustration with the carrier's position or pace of investigation does not automatically create a successful bad faith claim.

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§13.4 B. Explain Nature and Limitations of Policy

Although in extraordinary cases viable tort and other theories may be available to circumvent the limitations imposed by contract and statutory regulation of title insurance and other title company products, the potential plaintiff in a title insurance case needs to understand that title insurance litigation is essentially contract litigation in which recovery will be constrained by contractual limitations such as policy limits, policy exclusions, and the absence of attorney fees clauses. Unreasonable expectations by the claimant, often not fully articulated to counsel, can also arise from fundamental and widespread misunderstandings about the nature and function of title insurance and related products such as preliminary reports. See chaps 5-8. Anecdotal reports indicate that consumers of title insurance policies and recipients of preliminary reports often believe—because of the way their title policy documents are labeled or what they have been told by brokers, escrow agents, and even insurance company employees—that the policy contains representations about the status of title.

As discussed fully elsewhere (see §§11.38-11.44), both statutory and case law now tend to characterize preliminary reports as "mere offers" and title policies as contracts of indemnity with little or no representational element. Notably, the term "title" was dropped from the nomenclature for a preliminary report. Compare, *e.g.*, Ins C §12340.1 with Ins C §§12340.10-12340.11. See, *e.g.*, *Southland Title Corp. v Superior Court* (1991) 231 CA3d 530, 535, 282 CR 425; *Lawrence v Chicago Title Ins. Co.* (1987) 192 CA3d 70, 77, 237 CR 264. For a case expressing exasperation with the persistence of consumer misunderstanding (but perpetuating the confusion over nomenclature), see *Siegel v Fidelity Nat'l Title Ins. Co.* (1996) 46 CA4th 1181, 1185, 54 CR2d 84 ("parties to real estate transactions continue to misunderstand the purpose of preliminary title reports and title insurance policies and mistakenly rely on the accuracy of the information contained in those documents"). See §§11.39, 11.42.

The insured may also be unclear about conceptual distinctions between title insurance and other types of insurance. For a decision exploring the boundaries between title insurance and general insurance, see *Rosen v Nations Title Ins. Co.* (1997) 56 CA4th 1489, 1496, 66 CR2d 714; *Lick Mill Creek Apartments v Chicago Title Ins. Co.* (1991) 231 CA3d 1654, 283 CR 231. Although viable theories may be available in some cases to challenge or go beyond the usual policy terms, the potential plaintiff in a title insurance case needs to understand from the outset the limitations generally imposed by contractual and statutory restrictions on both coverage and remedies under policies, preliminary reports, and other title insurance products. See §§2.2-2.3.

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IV. PARTIES TO ACTIONS ON INSURED CLAIMS

A. Procedural Distinctions Between First and Third Party Claims

§13.5 1. No Privity Between Insurer and Third Party

The distinction between first and third party claims is important in evaluating title and title insurance claims. See §§11.3, 11.51. Although the title insurer may be the probable source of repayment in both types of cases, first party and third party cases differ dramatically at a procedural level. As discussed more fully in chap 11, first party claims involve a claim by the insured against the title insurer with which the insured is in contractual privity. *California Shoppers, Inc. v Royal Globe Ins. Co.* (1985) 175 CA3d 1, 67, 221 CR 171. Actions to enforce such first party claims usually, but not always, arise from a denial of coverage, a dispute over the amount of the loss, or the carrier's failure to respond reasonably or in a timely manner to a claim or a threat against the insured's title. See generally §§11.4, 11.16.

Third party claims are asserted against the insured by a noninsured person whose claimed interest is inimical to that of the insured and whose claimed interest at least potentially implicates the insured's title insurance coverage. See, *e.g.*, *Murphy v Allstate Ins. Co.* (1976) 17 C3d 937, 943, 132 CR 424. When the insurer does not acknowledge coverage and settle such claims, the claimant must sue the insured, not the insurer. See §11.51. For an example of how first and third party claims can interact and become intertwined, see *Moe v Transamerica Title Ins. Co.* (1971) 21 CA3d 289, 98 CR 547.

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§13.6 2. Statute of Limitations

Unlike first party claims, a variety of limitations periods affect third party claims, ranging from the relatively short periods for creating and enforcing mechanics' liens (see CC §§3097, 3115-3116, 3144, 3295.5) to the long periods for ejectment actions and claims of prescriptive rights (see CCP §§315-330). See §§11.51-11.58.

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§13.7 3. Lis Pendens May Be Required

In virtually every lawsuit involving a dispute between parties asserting interests in title to, or the right to possession of, real property, or concerning the use of an easement, a lis pendens (recorded notice of pending action) is necessary to give constructive notice of the dispute to those who may acquire or attempt to enforce their own interests in the subject property. CCP §§405-405.20. A lis pendens is frequently recorded in title-insurance-related actions involving the enforcement of third party claims and is generally not pertinent to first party actions between an insured and its insurer. See §11.53. In quiet title actions, partition lawsuits, and certain enforcement proceedings involving governmental rights and interests in property, a lis pendens is mandated by statute. See examples and authorities in California Real Property Remedies and Damages §13.2 (2d ed Cal CEB 2002).

Any court decree or judgment resulting from the action for which notice has been properly prepared and recorded relates back to the date the notice is recorded. CCP §405.24. See generally Real Property Remedies, chap 13. The efficacy of a lis pendens as imparting constructive notice terminates, however, when judgment is entered against the plaintiff in the underlying action. *Garcia v Pinhero* (1937) 22 CA2d 194, 197, 70 P2d 675. There is a split of authority on whether a lis pendens imparts constructive notice of the plaintiff's asserted rights in the subject property when judgment is entered in the plaintiff's favor. Compare *Contini v Western Title Ins. Co.* (1974) 40 CA3d 536, 542, 115 CR 257, with *Ahmanson Bank & Trust Co. v Tepper* (1969) 269 CA2d 333, 342, 74 CR 774.

PRACTICE TIP: Although a lis pendens is not mandated by statute for every action asserting an interest in real property, a third party claimant for which the relation-back doctrine of CCP §405.24 would provide any advantage should record a lis pendens. The prevailing party in the action should consider recording a certified copy of the judgment as soon as possible after it becomes final, particularly in view of the lack of agreement among appellate courts on whether a lis pendens continues to impart constructive notice after the judgment becomes final.

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B. Necessary Versus Related Parties

§13.8 1. Interested Parties

In preparing the complaint, the pleader's goal should be to name as parties all persons or entitles who are the real parties in interest in the litigation (CCP §389) as well as all persons or entities with an interest in the property (CCP §389.5). For example, all present owners and lienholders and all contracting parties should be named in a specific performance action, and all junior lienholders should be named in an action for judicial foreclosure of a defaulted trust deed. The interests of any parties not so named are unlikely to be affected by the outcome of the litigation. See, *e.g.*, *Goodenow v Ewer* (1860) 16 C 461 (for exceptions, see *San Diego Realty v Hill* (1914) 168 C 637, 143 P 1021, and *Hagar v Astorg* (1904) 145 C 548, 79 P 68).

PRACTICE TIP: It is indicative of the centrality of title insurance to California real property practice that the best and safest means for plaintiff's counsel to be sure that all necessary parties have been named is to order a litigation guaranty from a title company. For further discussion of litigation guaranties, see chap 9.

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§13.9 2. Third Party Suits

In third party actions against an insured on a covered matter, the insurer is seldom named as a party even though the insurer is often the main economically interested player (most clearly when coverage is undisputed and the claim is within policy limits). A person who is not a named insured has no grounds for recovery under a policy and has no legal basis to name the insurer as a party to the action. See generally *Stagen v Stewart-West Coast Title Co.* (1983) 149 CA3d 114, 119, 196 CR 732; *Kenny v Safeco Title Ins. Co.* (1980) 113 CA3d 557, 561, 169 CR 808. Note, however, that noninsured third parties may sue a title company directly on several theories, if applicable, such as slander of title, mishandling of escrow, and other torts. See §§11.46-11.49.

One who is not an insured, but who has a lien against real property on which a another person is insured, cannot bring an action against the insurer for negligence. *Smith v Commonwealth Land Title Ins. Co.* (1986) 177 CA3d 625, 631, 223 CR 339. Even when the insurer is a proper party, a reinsurer (with whom the prime insurer has reinsured in order to spread risk) is not a proper party absent a contractual provision giving the insured a direct right of action against the reinsurer. *Prudential Reins. Co. v Superior Court* (1992) 3 C4th 1118, 1125, 14 CR2d 749.

PRACTICE TIP: Counsel for an insured who is a defendant in a third party case may be tempted to join the title insurer as a cross-defendant in the same action if the carrier denies coverage or issues a reservation of rights. This would be a permissive, not a necessary, joinder of parties. See §13.11. Although the Code of Civil Procedure generally permits such joinder of claims (see CCP §§378-379), it is often a tactical mistake to join the third and first party cases. For example, if the third party case against the insured will be tried to a jury, the joinder of claims is likely to result in the jury's becoming aware that the insured has coverage. Moreover, accusations between the insured and the insurer can easily undermine the insured's credibility or jury appeal in the third party case, particularly when the insurer seeks rescission of the policy or invokes policy exceptions. Counsel who have brought the first party coverage claim as a cross-action in the third party case may find themselves sheepishly moving to sever or bifurcate cases that never should have been joined in the first place. See §11.15.

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§13.10 3. First Party Suits

The parties to a typical first party title insurance case are the insured owner or lender and the title insurance company. Although some practitioners might disagree, no particular advantage seems to derive from being the party who has filed first and thus obtained the mantle of plaintiff. In evaluating the appropriate parties to title insurance litigation, counsel should pay particular attention to the definition of "parties" as set forth in Part II of the applicable policy. See, *e.g.*, Condition 1 of the 1990 CLTA standard coverage policy (CLTA policy). See §§6.60-6.61. This policy language can be found in App H.

Counsel for the insured, in particular, should review the case carefully to evaluate whether an advantage can be gained by adding additional parties based on various theories of liability. Categories of potential additional parties to a first party dispute include:

- Attorneys, appraisers, and real estate brokers or agents;
- Coinsurers, underwritten title companies (particularly on an abstractor theory (see §§11.38-11.41) or if collusion is evident (see *Moe v Transamerica Title Ins. Co.* (1971) 21 CA3d 289, 98 CR 547));
- Other parties to the underlying transaction, such as buyers, sellers, lessors, lessees, and escrow agents; and
- Lenders, mortgage brokers, and junior lienholders.

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§13.11 C. Permissive Joinder of Claims

Synergy and advantages can sometimes be gained by combining insurance and noninsurance claims. For example, combining claims against a title insurer with claims against an underwritten title company, escrow holder, lender, title abstractor, or others may give plaintiff's counsel a wider range of legal theories and a broader scope of potential jury instructions than any one theory standing alone. For an example of a case in which a third party claimant unsuccessfully sought to take advantage of combined claims against a title company in various roles, see *Siegel v Fidelity Nat'l Title Ins. Co.* (1996) 46 CA4th 1181, 54 CR2d 84. Combining claims can mute the insurer's ability to excuse itself from the dispute by tendering policy limits under the title insurance policy. See §§12.54-12.56.

Similarly, joinder of claims against the title insurer with claims against other professionals who are believed to be at fault, such as brokers, attorneys, or appraisers, can often result in interdefendant disputes and cross-claims, which assist in both the discovery and proof of the plaintiff's case. The other side of this coin is that the addition of claims with multiple defendants may also make the case prohibitively expensive and usually enables the defendants to educate one another. (See also considerations in the Practice Tip in §13.9.) Consequently, plaintiff's counsel should carefully consider potential permissive joinder under CCP §379, and weigh the advantages and disadvantages of combining insurance and noninsurance claims.

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§13.12 V. JURISDICTION, VENUE, AND FORUM

Title insurance and related litigation does not usually present unusual or particularly difficult choices for jurisdiction, venue, or forum. However, before filing suit, counsel should carefully review the policy to discover the existence of any binding provisions for mediation, arbitration, or forum selection. Most policies, particularly those issued after 1990, provide for mandatory and binding arbitration of disputes between the insurer and the insured, depending on the amount in controversy and whether one party or the other demands arbitration. See, *e.g.*, Condition 13 of the CLTA policy, which, depending on the amount of the claim, provides for arbitration of disputes "arising out of or relating to" the title policy. See also Condition 13 of the 1992 and 2006 ALTA lender's policies and Condition 14 of the 1992 and 2006 ALTA owner's policies. These policy forms are found in Apps H-L, respectively. Arbitration procedures are fully discussed in chap 14.

If arbitration is not required, venue is proper in any court where such categories of claim may be brought, because most title insurance litigation involves conventional claims for breach of contract, tort, or declaratory relief. In general, the plaintiff in a title insurance case has the ability to bring the action in the county where the transaction occurred or the county that is the principal place of business or residence of the defendant insured or insurer. See generally CCP §395.5; California Civil Procedure Before Trial, chap 8 (4th ed Cal CEB 2004).

PRACTICE TIP: *Venue:* Even though title insurance cases are generally venued according to contract or tort principles, it is often prudent, if possible, to file the case in the county in which the insured real property is located. This venue permits the efficient addition of "local action" claims for title to or possession of the real property should this become necessary during the course of the action. See generally CCP §392; *Ophir Silver Mining Co. v Superior Court* (1905) 147 C 467, 82 P 70.

PRACTICE TIP: *Subject Matter Jurisdiction:* All California counties have combined the municipal and superior courts as permitted by Cal Const art VI, §5. All civil actions are filed in superior court. The courts, however, classify cases in which the amount in controversy does not exceed $25,000 as limited civil cases. CCP §86. These cases have different pleading and more limited discovery rules. See CCP §§90-98.

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§13.13 VI. DISCOVERY STRATEGIES

Effective discovery depends primarily on a clear understanding of the issues and the elements of proof that must be established to support a particular claim or defense. Some experienced litigators, motivated by considerations of economy and recognizing that discovery educates both sides, are moving away from the "depose everybody" school of litigation toward a more selective use of discovery and increasing the element of spontaneity at trial. Although the discovery process varies widely, depending on the nature of the case, it is possible to give some guidance about methods and areas of discovery that are particularly useful in title insurance cases. See §§13.14-13.25.

CAVEAT: If the case is being arbitrated, discovery will likely be limited. CCP §1283.1(b). The American Arbitration Association Title Insurance Arbitration Rules have been superseded by the AAA Commercial Arbitration Rules and Mediation Procedures (CARs). For further discussion, see chap 14. Both sets of rules relax statutory restrictions on discovery. For example, 1987 Title Insurance Arbitration Rule 80 (1987 TIAR 80) allowed the arbitrator to order discovery of evidence on a party's request if the discovery is both reasonable and necessary to prepare and present the case. CAR R-21 permits the arbitrator to direct production of documents and other information. This process is still a far cry from the usual self-executing provisions of the discovery code (*e.g.*, CCP §§1985(c), 2020.210, 2025.210, 2030.020, 2031.020(a)-(b)) that a party enjoys in court litigation.

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A. Examination Under Oath

§13.14 1. Admissibility in Evidence

Sometimes an insurer takes advantage of its right to conduct an examination under oath of the insured (EUO) long before the insured files suit and sometimes even before the insured engages counsel. See §12.42. The EUO is often conducted in a format indistinguishable from a deposition during litigation. Insureds occasionally find that statements they made during the EUO are inconsistent with theories or facts later developed or discovered by their attorneys. Assuming that it is adequately documented, the EUO is probably admissible in evidence as both a party admission and as a declaration against interest. Evid C §§1220-1228.1, 1230-1238. In *Beasley v Pacific Indem. Co.* (1962) 200 CA2d 207, 210, 19 CR 299, the insurer did not introduce the EUO transcript into evidence, but read portions of it while cross-examining the insureds. Note also the admissibility of admissions by predecessors in title under Evid C §1225. Both insureds and their counsel are therefore well advised to apply the same degree of seriousness to an EUO as they would to a deposition. See §12.43.

PRACTICE TIP: Although a title insurer is not required to notify the insured of the advisability of obtaining legal representation for the EUO, such notice may later assist the insurer in responding to objections to the admissibility of the EUO transcript, based on the insured's lack of legal counsel. See §13.15. In addition, while the insured's right to be represented by counsel at an EUO under Ins C §2071.1 does not apply to claims under title policies, the insured may argue that the title insurer's duty of good faith requires it to extend to the insured the rights afforded under §2071.1, or that §2071.1 reflects the standards of the industry in regard to EUOs. See discussion at §12.42. But see *Tomaselli v Transamerica Ins. Co.* (1994) 25 CA4th 1269, 1281, 31 CR2d 433, allowing bad faith claim to go to jury when insurer forced insured to submit to EUO, dissuaded insured from having attorney present, and misled insured about the purpose of the EUO. Even if no notice is given, the insured may consult counsel simply as a result of the insurer's exercising its rights to conduct an EUO, which may then cause the settlement figure to increase, because the insured will want to recoup legal expenses as well as other losses. Consequently, counsel for the insurer may want to consider the advantages of negotiating a settlement without an EUO.

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§13.15 2. Objections to Admissibility

Depending on events preceding the EUO, it may be possible to argue that the EUO is inadmissible during trial or arbitration because the EUO does not qualify as "former testimony" under Evid C §1290 or because it was part of a privileged settlement process and thus inadmissible under Evid C §1152. However, counsel and the insured should not rely on a settlement privilege argument unless the insurer has agreed in writing or on the record in the EUO that the examination is intended to be privileged or protected. If the EUO was taken before the insured retained counsel, the insured has another basis for arguing against admissibility of the EUO. A refusal to allow an EUO in the face of policy language providing for such an examination would probably constitute a breach by the insured of the duty to cooperate with the insurer's investigation, which could destroy coverage and would certainly make far more difficult any claim of insurer bad faith during its investigation. See §§11.104-11.105, 12.44-12.46.

PRACTICE TIP: Counsel for the insured should prepare the client for an EUO with the same detail and focus that would be used in deposition preparation. To facilitate that preparation, counsel for the insured may prepare at least a rough outline of the coverage and other issues that will arise if the insurer denied coverage, reserved rights, or pursued policy rescission. On one hand, the fact that an insurer has previously taken an EUO is not likely to serve as a basis for the insured's effort to avoid or limit the taking of a deposition once a case is convened, because the pleadings would not have been filed and the legal dispute may not have been fully framed at the time of the EUO. On the other hand, the tactical advantages to an insurer of taking a prearbitration EUO may provide a basis for the insured to obtain permission to take depositions or conduct discovery otherwise not available in arbitration. See §13.13 and chap 14.

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B. Discovery Methods

§13.16 1. Document Requests

Both insured and insurer will want to obtain and review all documents in the opposing parties' possession or control that might bear on coverage. From the insurer's point of view, such documents would include any that relate to the insured's status (or failure to qualify) as a bona fide purchaser for value and documents relating to everything the insured knew about the property or the competing interest at the time of the purchase or extension of credit. See chaps 4-5, 11.

The insured should focus on documents relating to the methodology by which the insurer searched title, prepared the policy, and determined coverage issues in the claims process, including the insurer's underwriting and claims manuals. See *Glenfed Dev. Corp. v Superior Court* (1997) 53 CA4th 1113, 62 CR2d 195. The insured is particularly advised to search for documents relating to any "write over" by the carrier, *i.e.,* any decision not to list as an exception to coverage an encumbrance, matter, or cloud on the title actually known to the insurer or to its underwritten title company.

EXAMPLE: In *Moe v Transamerica Title Ins. Co.* (1971) 21 CA3d 289, 98 CR 547, the title company, acting as both insurer and escrow agent, deliberately omitted any reference to a bankruptcy and liens affecting title to property, in furtherance of a conspiracy to sell to the insured a worthless note misrepresented as being secured collaterally by a note and deed of trust, both of which were also worthless. See discussion of *Moe* and other cases in §11.48.

The insured's discovery plan should include all relevant documents and files, including:

- Title and underwriting files (sometimes called "search notes") and related manuals;
- Correspondence between the title insurer and its underwritten title company;
- Escrow files and related manuals;
- Claims files and related manuals;
- If third party claims are involved, lender files, broker files, and party correspondence; and
- If a foreclosure is involved, any foreclosure or trustee sale files.

Some of these files may require the propounding party to use consumer records notice procedures under CCP §1985.3. The insured should not settle for only the "official" files, but should seek production of any "personal" files in the custody of the specific title officers, escrow agents, underwriters, claims counsel, and others involved in the transaction, whether or not they are still employed by the insurer. Internal e-mails and expense vouchers are often particularly candid and unguarded sources of information. When the insurer has the advantage of having taken a EUO, counsel for the insured should generally attempt to complete document discovery and take depositions quickly and demand production of the EUO.

In addition, more companies are using e-mail for internal as well as external communications. E-mail may not be produced in response to a request for claims files, even one framed very broadly. Reportedly, some companies refer to e-mail communications as being in the "e-file" or "electronic file," rather than the claim file. Counsel for insureds should also specifically request copies of all e-mail or other communications sent by computer. See CCP §1985.8; California Civil Discovery Practice, chap 4 (4th ed Cal CEB 2006).

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§13.17 2. Interrogatories

The insurer will often find that the insured is not the person most knowledgeable about the property or the factual background of the claim. Others, including other principals to the transaction, brokers, attorneys, lenders, escrow agents, and the staff of underwritten title companies, often have more detailed information bearing on the claim. Title and escrow company personnel as well as brokers are often quite mobile and may not remain available very long after litigation is commenced. Consequently, early in the case each side should propound interrogatories or request documents to obtain the names of witnesses and the means to get in touch with everyone who meaningfully participated in the transaction. Interrogatories should also be propounded to discover the supporting facts for the other party's defenses.

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§13.18 3. Depositions

It is often important to depose any title insurance company employees or agents who had direct contact with the insured. Depositions of these persons may reveal that they are as confused about the function and limitations of title insurance as are many insureds and some lawyers and courts. This confusion can lead such employees or agents, sometimes quite innocently, to make statements before the policy is issued, which give rise to expectations on the part of the insured that are actionable in contract or tort. See, *e.g.*, *Paper Savers, Inc. v Nacsa* (1996) 51 CA4th 1090, 59 CR2d 547; *Desai v Farmers Ins. Exch.* (1996) 47 CA4th 1110, 55 CR2d 276. See also §§11.24, 11.26. Depending on the seniority and authority (both actual and apparent) of these persons, such statements may be the key to developing a title insurance, abstractor, or escrow claim that might otherwise be legally infirm.

Insureds occasionally attempt, at least in part for "impact," to depose chief executives or others in policy-making positions in an insurance company who had no personal involvement in the transaction leading to the litigation. In *Liberty Mut. Ins. Co. v Superior Court* (1992) 10 CA4th 1282, 1289, 13 CR2d 363, the court of appeal issued a writ requiring the superior court to enter a protective order when the insured seeking the discovery could not show that the deponent in question had unique or superior knowledge.

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C. Discovery Topics and Their Scope

§13.19 1. How the Industry Functions

The most useful single factor for an insured in conducting effective discovery in title insurance cases is an understanding of how title insurance, title insurers, and related enterprises work on a daily basis. For example, most title insurance companies offer a variety of products and functions, which are supplied by different departments (sometimes called "desks"). One occasionally hears of escrow officers and an escrow desk; title officers and a title desk or department; foreclosure officers and a trustee's sale desk; underwriters and an underwriting (*i.e.,* insurance) department; and a claims desk or department. Often, title company personnel discuss these desks or departments as if they are parts of wholly unrelated companies. Communications, or their lack, between these sometimes poorly coordinated and occasionally conflicting arms of the title insurance company can be valuable sources of discovery or indicators of actionable malfeasance.

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§13.20 2. Insurer's Relationship to Underwritten Title Company

It is useful to understand the relationship between title insurers and underwritten or local title companies. See §1.5. Discovery of the underwriting agreement or agency contract between the insurer and the local title company is frequently helpful. Sometimes the title search is performed by one title company, and the actual insurance underwriting is done by a different title insurance company (or, on large projects, perhaps several insurers). When a title company does its title search it is, in a sense, preparing a partial abstract of title for the insurer by starting with at least a computer run showing recorded documents affecting title for the 10 years immediately preceding the transaction. This process enables the insurer to call out and except all known interests, encumbrances, and problems in its policy. Communications documents between the underwriter and the title company, both at the stage of policy issuance and at the claims stage can be a highly productive source of information. For cases involving this interplay between underwriter and title searcher, see, *e.g., Contini v Western Title Ins. Co.* (1974) 40 CA3d 536, 115 CR 257; *Moe v Transamerica Title Ins. Co.* (1971) 21 CA3d 289, 98 CR 547. For similar reasons, communications between coinsurers and between insurers and reinsurers can also be useful.

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§13.21 3. Insurer's Financial Condition

Pretrial discovery related to the issue of punitive damages of a party's financial condition is prohibited under CC §3295(c) and limited by common law and the constitutional protection of financial privacy (see, *e.g.*, *Valley Bank v Superior Court* (1975) 15 C3d 652, 657, 125 CR 553; *Cobb v Superior Court* (1979) 99 CA3d 543, 550, 160 CR 561), unless the party seeking such information can obtain an order to the contrary. Such an order must be based on a finding that the party seeking financial information is substantially likely to prevail on a punitive damages claim. CC §3295(c); *Kerr v Rose* (1990) 216 CA3d 1551, 1565, 265 CR 597.

An insured, independently of punitive damages claims, may be able to obtain information in the insurer's files about the reserves established on a third party claim and documents relating to reinsurance when allegations have been made that the insurer is guilty of bad faith for failing to defend or properly handle a third party claim. See *Lipton v Superior Court* (1996) 48 CA4th 1599, 1614, 56 CR2d 341; *Samson v Transamerica Ins. Co.* (1981) 30 C3d 220, 240, 178 CR 343. In *Fireman's Fund Ins. Co. v Superior Court* (1991) 233 CA3d 1138, 286 CR 50, the court held to be an abuse of discretion a trial court order requiring disclosure of communications between an insurer and a reinsurer without an in camera inspection by the court. In *American Protection Ins. Co. v Helms Concentrates, Inc.* (ED Cal 1991) 140 FRD 448, however, the court held that an insurer's reserves established for a first party claim were not discoverable.

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4. Insurer's Claims Files

§13.22 a. Relating to Insured's Claim

Discovery of the insurer's claim file relating to the insured (see §13.16) is often a sensitive area because it sometimes impinges on an area that has the "feel" of one that could be privileged either as work product or an attorney-client communication. See *State Farm Fire & Cas. Co. v Superior Court* (Taylor) (1997) 54 CA4th 625, 638, 62 CR2d 834, cited in §13.24. The countervailing consideration, at least in third party claims, is that the insurer is conducting the claims investigation not only for its own benefit or protection but also under a duty owed to the insured. Even though the claims file in a third party claim may not be discoverable by the third party (see *Travelers Ins. Co. v Superior Court* (1983) 143 CA3d 436, 450, 191 CR 871), the insured is usually able to discover the third party claims file because it contains matters of common interest (see *Glacier Gen. Assur. Co. v Superior Court* (1979) 95 CA3d 836, 842, 157 CR 435).

In first party claims, also, there are situations in which the conduct of the insurer in handling the claim, and in responding to discovery requests in litigation between the insurer and its insured, is egregious enough to permit discovery of claim files maintained by the insurer, even though the information may otherwise be privileged. See *State Farm Fire & Cas. Co. v Superior Court* (Taylor) (1997) 54 CA4th 625, 643, 62 CR2d 834.

The supreme court's decision in *White v Western Title Ins. Co.* (1985) 40 C3d 870, 221 CR 509, suggested that the claims file is both fully discoverable and available to prove the occurrence of bad faith even after litigation has begun. However, the *White* decision has been subjected to considerable criticism by both the judiciary and the bar. See *Palmer v Ted Stevens Honda, Inc.* (1987) 193 CA3d 530, 537, 238 CR 363; Beasley, *White v Western Title: The Point of Diminishing Returns*, 14 W St U L Rev 191 (Fall 1986). The *White* opinion on this issue is also implicitly limited by the supreme court's analysis in *State Farm Fire & Cas. Co. v Superior Court (Taylor), supra*. For discussion of discovery of the claims files generally, see Garrity, *Discovery of an Insurer's Files*, XX The Forum 20 (Fall 1984).

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§13.23 b. Relating to Other Insureds' Claims

Efforts to discover a particular insurer's pattern in handling other claims has been the subject of several opinions in the insurance area generally. In *Colonial Life & Acc. Ins. Co. v Superior Court* (1982) 31 C3d 785, 791, 183 CR 810, the court held that the ability to discover the insurer's handling of other claims may be relevant to show a knowing violation and to establish a basis for punitive damages. Production of such information, however, is limited by considerations of burden and oppression. Compare *Mead Reins. Co. v Superior Court* (1986) 188 CA3d 313, 320, 232 CR 752, with Ins C §791.13.

It has been held outside of California that a third party claimant, as the insured's assignee, cannot compel discovery of the insurer's entire file until coverage is established. *Allstate Ins. Co. v Swanson* (Fla App 1987) 506 So2d 497.

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§13.24 5. Claims File of Attorney for Insurer

Controversy has also arisen over discovery directed at attorneys involved in the claims process. For example, in *2,022 Ranch, LLC v Superior Court* (2003) 113 CA4th 1377, 7 CR3d 197, the title insurer contended that the factual investigation by its in-house claims adjusters, who were also licensed attorneys, was protected from discovery by the attorney-client and work product privileges. The court held that employing attorneys to conduct routine claims investigations does not make their factual investigations subject to the attorney-client privilege. The court explained that evidence reflecting the insurer's factual investigation of the claim is subject to discovery. Under the dominant purpose test (113 CA4th at 1390),

> if it appears the communication is made to serve a dual purpose—one for transmittal to an attorney "in the course of professional employment" and one not related to that purpose—the question presented to the trial court is as to which purpose predominates.

Only those communications reflecting the requesting of, or rendering of, legal advice are protected by the attorney-client privilege, and only the attorney's legal impressions, conclusions, opinions, or legal research or theories are subject to the work product doctrine. To make such determinations, the court will likely need to examine each deposition question or each document request to determine what was the dominant purpose of those communications. 113 CA4th at 1397. See also *Chicago Title Ins. Co. v Superior Court* (1985) 174 CA3d 1142, 1154, 220 CR 507 (attorney employee of title company whose activities had gone beyond conventional lawyer role could not assert attorney-client privilege or attorney work product protections). But see *Transamerica Title Ins. Co. v Superior Court* (1987) 188 CA3d 1047, 233 CR 825 (no waiver found when attorney opinion was voluntarily produced in effort to prove insurer's conduct was reasonable).

If an attorney enables or assists an insurance company in planning or perpetrating fraud in the handling of insurance claims and suits against the company, the attorney files may be discoverable under the crime/fraud exception to the attorney-client privilege. *State Farm Fire & Cas. Co. v Superior Court* (Taylor) (1997) 54 CA4th 625, 643, 62 CR2d 834. The work product privilege may also be disregarded under such circumstances if there is substantial evidence that refusal to allow the discovery would unfairly prejudice the insured and result in an injustice. 54 CA4th at 649. See discussion of *State Farm* at 19 CEB Civ Litigation Rep 169 (June 1997).

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§13.25 6. Other Discovery Areas

In addition to the discovery areas discussed in §§13.19-13.24, each party may want to consider pretrial discovery of the following, according to the needs of the case:

- Information relating to the insured's status (or failure to qualify) as a bona fide purchaser for value (see §13.16);
- Information showing what the insured knew about the property or the competing interest at the time of the purchase or extension of credit (see §13.16);
- The methodology by which the insurer searched title and prepared the policy, including underwriting files and manuals, correspondence and agreements between the title insurer and the underwritten title company, and information relating to any decision not to list an encumbrance as an exception to coverage (see §§13.16, 13.20);
- Documents and files relevant to the transaction at all stages, including title files, claims manuals and files (see §§13.22-13.23), escrow manuals and files, lender files, broker files, and, if a foreclosure is involved, foreclosure or trustee sale files (see §13.16);
- Names and addresses of percipient witnesses (see §13.17); and
- Written and oral communications between the insured on the one hand and the insurer and its representatives on the other (see §§13.16, 13.18).

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§13.26 VII. EXPERT CONSULTANTS AND WITNESSES

The old saw about knowing just enough to be dangerous is particularly relevant to the issue of using experts in title insurance litigation. Since ordinary contract, tort, and insurance law principles are at the center of such litigation, it is quite easy for attorneys inexperienced in title insurance matters to assume that they can dispense with experts entirely or at least that they can safely delay their engagement until the expert disclosure deadline imposed under CCP §§2034.210-2034.310. Such an assumption is usually a mistake. Although the law of title insurance is built with familiar legal building blocks, it has its own legal and business culture, as anyone discussing a preliminary report or a title insurance "write over" with title counsel quickly learns. Most California courts generally treat title and title insurance issues as sufficiently beyond the common knowledge of either judges or juries that they allow noncumulative testimony by title insurance experts.

In most title insurance disputes, it is wise to engage appropriate experts early in the process, preferably while the case is still in the claims process. See §12.18. The availability of a knowledgeable expert with a strong title insurance background often helps to avoid the culture clashes and miscommunications that can lead to denial of a claim and the need to file a lawsuit. For general guidance on the selection and use of expert witnesses, see Brosnahan, *Trial Practice: Dealing With Experts in the '90s*, 19 CEB Civ Litigation Rep 275 (Nov. 1997) and California Expert Witness Guide (2d ed Cal CEB 1991). As with virtually all discovery and expert selection, the key to success is an early, systematic, and realistic analysis of what the client can and must seek to establish at trial. See generally chap 11.

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Source: Real Property/California Title Insurance Practice/13 Litigation Strategies and Procedures/§13.27 A. Protecting Consultant Privilege

§13.27 A. Protecting Consultant Privilege

An expert consultant who has not been disclosed as a potential witness is generally protected by the attorney-client privilege or work product protection if the expert's input is necessary to permit client and attorney to communicate effectively and to analyze and develop the case. *Brokopp v Ford Motor Co.* (1977) 71 CA3d 841, 857, 139 CR 888; *National Steel Prods. Co. v Superior Court* (1985) 164 CA3d 476, 488, 210 CR 535. Consequently, expert consultants may be engaged and may freely give and receive information without fearing that confidentiality will be compromised. California Expert Witness Guide §1.4 (2d ed Cal CEB 1991). Once an individual is disclosed as an expert witness who will testify at trial, any prior attorney-client or work product privilege is lost. *Brokopp v Ford Motor Co.* (1977) 71 CA3d 841, 857, 139 CR 888; *County of Los Angeles v Superior Court* (1990) 224 CA3d 1446, 1458, 274 CR 712.

PRACTICE TIP: In larger cases, counsel in title insurance matters sometimes engage consultant experts that are different from their expert witnesses, and limit interaction between the two. If counsel is unsure whether an expert consultant will eventually be used or needed as a witness, particular care should be given to information and documents provided to the expert, notes and records taken by the expert, and provisional opinions expressed by the expert.

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§13.28 B. Categories of Experts

Although it is not feasible to provide an exhaustive list of all categories of potential experts that might be useful in a case involving title or title insurance, it is possible to identify recurring topics that often become decisive in title insurance litigation. In listing these categories separately, it is not suggested that a separate expert must be engaged for each topic. The same expert can often credibly and persuasively cover nearly all relevant subjects for expert consulting and testimony.

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§13.29 1. Coverage Experts

Both insurer and insured may want to retain coverage counsel to assist in analyzing coverage issues. For the insured, the role of this expert is often twofold: To verify that coverage exists and to express opinions on whether a denial of coverage was unreasonable and, at least inferentially, in bad faith. See §11.16. In considering the employment of such an expert, it is well to remember that it is relatively unusual for coverage issues to turn on conflicting extrinsic evidence and that sometimes, according to practices that vary within the industry, the insurance contract and endorsements are standardized and not subject to negotiation. When no conflicting extrinsic evidence is offered, the interpretation of the contract is a matter of law for the trial court and, on *de novo* review, for the appellate court. *City of Manhattan Beach v Superior* Court (1996) 13 C4th 232, 238, 52 CR2d 82; *Parsons v Bristol Dev. Co.* (1965) 62 C2d 861, 866, 44 CR 767. See §§11.15, 13.34.

In any event, trial courts recognize that title insurance is a specialized and somewhat arcane area and frequently exercise their discretion to allow expert testimony on coverage issues as helpful to the trier of fact in making its legal or factual analysis. Regardless of whether an expert ultimately testifies at trial, retaining such experts can be quite helpful to counsel who are unfamiliar with unusual aspects of title insurance.

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§13.30 2. Claims Experts

Experts on claims handling are typically retained when an issue has arisen as to whether the insurer has made a reasonable and good faith claims investigation. An opinion that an investigation was not reasonable or in good faith may be offered in support of a claim for breach of the implied covenant of good faith and fair dealing. Generally, but not always, cases involving a claim of unreasonable claims-handling turn on disputed factual details rather than the legal interpretation of policies and coverages. (See discussion throughout chap 12 of statutes and regulations applicable to claims process.) As a result, testimony by claims experts is more likely to be offered to a jury, and an expert with good jury appeal should be chosen accordingly. A key element of this appeal is the expert's ability to act as an effective translator of the language and practices that are peculiar to title insurance.

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§13.31 3. Damages Experts and Appraisers

Title insurance claims can sometimes be quite easy to quantify. One example is an insured owner who finds that her property is encumbered by a small lien or trust deed against which she is insured. In this event, the title insurance company often simply pays the amount necessary to eliminate the lien. See §12.58. But even claims that would seem to be easily quantified can be far more complicated and difficult to liquidate than they appear. For example, as against an insured lender, the insurer would probably contend that the lender had no actionable or quantifiable loss unless the security represented by the insured deed of trust is threatened, such as when the loan is in default and the value of the property, with its covered title defect, is less than what is owed to the lender at or beyond the date of foreclosure by the lender. For a more detailed analysis of this issue, see *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 275 CR 107, and *Karl v Commonwealth Land Title Ins. Co.* (1993) 20 CA4th 972, 24 CR2d 912, which are compared in §§11.12-11.14.

In other title insurance cases, proof of loss occasionally requires complex and sophisticated damages testimony by a variety of experts:

EXAMPLE 1: An insured whose title to an **access easement or right of way** is in doubt might need to offer the testimony of (a) an appraiser concerning impact on market value; (b) a civil engineer about the feasibility or desirability of alternative means of access; and (c) a title expert or an attorney about the unavailability of alternative legal approaches such as condemnation, way of necessity, or prescriptive rights.

EXAMPLE 2: Title insurance issues on **common development covenants, conditions, and restrictions** may require a mix of expert testimony by brokers, appraisers, lawyers, and contractors to establish a valid measure of damages.

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§13.32 4. Experts on Collateral Issues

As discussed in §13.11, title insurance disputes often coexist with other kinds of disputes. Some examples of those disputes and the kinds of experts they might require are:

- **Escrow disputes and premature close claims:** Escrow experts, attorneys, conveyancing experts (see §11.47);
- **Broker and sales agent malpractice claims:** Experts on broker and sales agent practices, precautions, and standards of care;
- **Attorney malpractice:** Experts on attorney standards of care;
- **Abstractor negligence:** Title search and abstracting experts (see §§11.38-11.41);
- **Foreclosure disputes:** Experts on nonjudicial foreclosure, posting, publishing, and serving foreclosure notices and practices at foreclosure auctions concerning qualification of bidders, postponement, and bidding;
- **Priority disputes:** Legal and title experts on loan modifications, priorities, and recording acts; and
- **Fraud, conspiracy, and embezzlement cases:** Banking experts, financial experts, and experts on real estate transactions and closing (see chap 10, §§11.45-11.50).

NOTE: All of the foregoing may require damages experts, bankruptcy experts, legal experts, and accounting experts.

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§13.33 VIII. SUMMARY JUDGMENT AND SUMMARY DISPOSITION OF ISSUES

Both insurer and insured should consider using pretrial procedures to narrow or eliminate issues or causes of action for trial. The usual methods are demurrers, motions for summary judgment or summary adjudication of issues, motions for judgment on the pleadings, and motions in limine (see §13.37). Sections 13.34-13.35 focus on the peculiar nature of title insurance litigation and issues that lend themselves to disposition by summary judgment or summary adjudication. The basic standards and procedures for motions for summary judgment and summary adjudication of issues in title insurance litigation are no different from those in any other civil case. See generally CCP §437c; *Lawyers Title Ins. Corp. v Feldsher* (1996) 42 CA4th 41, 49 CR2d 542; *Molko v Holy Spirit Ass'n* (1988) 46 C3d 1092, 252 CR 122 (non-title-insurance case). A motion for summary judgment has been expressly approved for the prehearing resolution of cases in contractual arbitration. *Schlessinger v Rosenfeld, Meyer & Susman* (1995) 40 CA4th 1096, 1105, 47 CR2d 650 (for further discussion, see chap 14). For summary judgment procedures, see California Civil Procedure Before Trial, chap 36 (4th ed Cal CEB 2004).

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Source: Real Property/California Title Insurance Practice/13 Litigation Strategies and Procedures/§13.34 A. Insurer as Moving Party

§13.34 A. Insurer as Moving Party

Title insurance cases more frequently involve issues properly disposed of as a matter of law than is typical for commercial and contract disputes generally. Title insurers have had considerable success limiting coverage as a matter of law by employing summary judgment or pretrial motions, as in the following cases:

- *Vournas v Fidelity Nat'l Title Ins. Co.* (1999) 73 CA4th 668, 86 CR2d 490 (title insurer/escrow holder had no legal duty to investigate whether trustee of trust owning land had obtained consent of trust beneficiaries for sale);
- *Rosen v Nations Title Ins. Co.* (1997) 56 CA4th 1489, 1496, 66 CR2d 714 (alleged misuse of priming lien loan occurred after date of policy; title insurance applied only to defects in title as of date escrow closed, and misuse of loan was not a defect, a lien, or an encumbrance);
- *Southland Title Corp. v Superior Court* (1991) 231 CA3d 530, 538, 282 CR 425 (peremptory writ ordering demurrer sustained based on statute defining preliminary title report as offer only);
- *Cale v Transamerica Title Ins. Co.* (1990) 225 CA3d 422, 427, 275 CR 107 (summary judgment affirmed in "tortious breach" claim when plaintiff had not yet suffered damage); and
- *Barczewski v Commonwealth Land Title Ins. Co.* (1989) 210 CA3d 406, 413, 258 CR 386 (summary judgment granted to carrier on refusal to defend claim based on tortious conduct of insured).

The issue for the insurer is relatively straightforward: The insurer should pursue pretrial disposition of issues whenever a case or cause of action turns on a question of law. Insureds will, of course, resist such motions. The key for the insured in defeating these motions is to develop and emphasize the peculiar facts of a case that make it difficult and improper to limit it to broad generalizations about title insurance coverage. See §§11.15, 12.59.

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§13.35 B. Insured as Moving Party

A difficult issue for insureds is whether to pursue a motion for summary judgment. Experienced counsel for insureds tend to be sparing in their use of summary judgment and summary adjudication motions when the insured is the plaintiff in a claim for breach of contract and bad faith. Their concern is that such a motion would give away a great quantity of the insured's evidence and theories and, if successful, would remove the more interesting aspects of the case from the trial, thus preventing the jury from reacting to the drama of proving an insurer to have been wrong in its treatment of the insured. Successful motions for "partial" summary judgment can often leave the remaining aspects of the case dry and out of context.

The countervailing consideration is that success on a motion for summary adjudication or summary judgment may result in early settlement, obviating the need for a trial. Which side counsel takes on this issue depends on the size and open-endedness of the insured's damage claims and, perhaps most important, whether the bad faith aspects of the case are viewed as central or ancillary to other claims. The fee arrangements (hourly, flat, or contingency) and the possibility of counsel's aversion to trial may color this analysis.

The insured's tendency to "save the good stuff for trial" is less pronounced and justified in the relatively rare case in which the insured is a defendant in a declaratory relief action on coverage filed by the insurer and has not filed a cross-action for damages based on breach of contract or torts.

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IX. TRIAL OF TITLE INSURANCE DISPUTES

A. Jury Trials

§13.36 1. Jury or Court Trial?

If the insured has not submitted the title insurance case to binding arbitration (see chap 14), it is quite likely because counsel for the insured is insisting on a jury trial. This insistence is often based on the traditional plaintiff's preference for jury trial in tort cases and on the belief, probably correct in many counties, that a jury is more likely than a judge to award punitive damages or a large measure of compensatory damages. However, the insured's preference for trial by jury must be balanced by a recognition that title insurance cases have many features distinguishing them from traditional personal injury cases or even from more conventional kinds of insurance litigation. The relatively dry and esoteric fields of land titles and insurance can put even the most committed and serious jurors to sleep.

The insured in many title insurance cases is far from a typical injured motorist in terms of jury sympathy. Many title insurance cases are brought by institutional lenders, developers, and investors who have no particular advantage over insurance companies in terms of jury appeal and sympathy. As a rule, jury trials in pure title insurance cases are best left to the relatively few instances involving a sympathetic and relatively vulnerable insured and serious issues about insurer misconduct. However, the preference for a jury trial is often dictated by the related claims joined with the coverage dispute, such as claims against brokers, attorneys, appraisers, escrow officers, or other principals in the transaction. See §13.11.

As most title insurance cases involve claims at law, the right to a jury trial is well established absent an effective waiver. This right is somewhat more problematic in a pure declaratory relief coverage case. However, because the underlying right for which a declaration of rights is sought is contractual, the right to a jury trial is arguable if the coverage issue turns on factual, as distinct from purely legal, issues. *Grimes v Elite Ins. Co.* (1978) 82 CA3d 130, 142, 146 CR 808; *Straube v Security First Nat'l Bank* (1962) 205 CA2d 352, 363, 23 CR 213.

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§13.37 2. Motions in Limine

When a title insurance case will be tried to a jury, and particularly when there is a variety of related claims and defenses, serious attention must be given to making timely and appropriate motions in limine. The insurer will, of course, wish to exclude any reference to its wealth or reserves unless and until a verdict of fraud, malice, or oppression is returned. See CC §3295. The insurer will also seek to exclude evidence of coinsurance or reinsurance for the same reason that defendants do not want the jury to know that the claims against them are insured.

The motions in limine that the insured may wish to make are less stereotypical and more varied. Aside from the obvious issues of excluding cumulative expert testimony and any settlement demands or offers, the insured may attempt to use motions in limine (or bifurcation of issues) to simplify the case and to portray itself as much as possible as a generic insured rather than as a real estate sophisticate. Also, if summary adjudication of issues was seriously considered earlier in the case but rejected for tactical reasons (see §13.35), counsel may wish to reconsider whether a motion in limine, which is heard by the trial department on the eve of trial, presents any strategic advantages over a summary proceeding under CCP §437c.

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§13.38 3. Special Verdicts

Because of the complexity of title insurance issues and the potential for jury confusion, counsel for the insured should view special verdict forms with caution. Answers to the special verdict interrogatories can undermine and sometimes totally destroy the viability of a favorable verdict for the insured. The insurer, however, often wants to use special verdict forms, particularly in cases involving a complex interplay of fact and disputed law.

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§13.39 B. Attorney Fees as Damages

Recovering attorney fees in title insurance and related cases is possible if a party relies on the "third party tort" or "tort of another" theory for an award of fees, costs, and other litigation expenses, including company or personal time lost because of the dispute. *Prentice v North Am. Title Guar. Corp.* (1963) 59 C2d 618, 620, 30 CR 821; *Moe v Transamerica Title Ins. Co.* (1971) 21 CA3d 289, 303, 98 CR 547; *Ruth v Lytton Sav. & Loan Ass'n* (1968) 266 CA2d 831, 844, 72 CR 521. Bear in mind that such items sought under this theory are recovered as damages caused by the tortious conduct (see §11.9) and not as costs in the immediate litigation (see §11.34), and as such they should be proved as damages during trial and submitted to the jury with appropriate instructions.

When an insurer's bad faith compels the insured to retain counsel to recover amounts due under the policy, the insured may also recover the attorney fees and litigation expenses incurred to prove entitlement to policy benefits. *Brandt v Superior Court* (1985) 37 C3d 813, 819, 210 CR 211. Fees and expenses incurred to prove entitlement to policy benefits are recoverable; however, fees and expenses allocable to any other portion of the plaintiff's claims or damages are not. 37 C3d at 819; *White v Western Title Ins. Co.* (1985) 40 C3d 870, 890, 221 CR 509; *Track Mortgage Group, Inc. v Crusader Ins. Co.* (2002) 98 CA4th 857, 867, 120 CR2d 228; CACI 2350. See also §11.34.

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14

Arbitration Procedures

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§14.1 I. OVERVIEW

Most title policies contain clauses providing for mandatory or optional arbitration to resolve claims under the policy. See §14.2. This chapter addresses which issues are subject to arbitration, how the arbitration provisions in standard policies may be enforced or avoided, and the arbitration hearing procedures. Key distinctions between arbitration and litigation are outlined. On theories of liability (*i.e.*, the substantive law of claims and actions involving title insurance companies) and related defenses, see chap 11. On claims procedures, see chap 12. On litigation procedures and strategies, see chap 13.

If the parties are unable to agree on how a claim should be resolved, the next step is usually either arbitration or litigation. Condition 13 of the 1990 CLTA standard coverage policy and the 1992 ALTA lender's policy (see Apps H and I) and Condition 14 of the 1992 ALTA owner's policy (see App K) provide for binding arbitration of disputes arising from policies in which the policy limit is $1 million or less, if either the insured or the insurer demands arbitration. If the policy limit is greater than $1 million, consent of both the insured and the insurer is a prerequisite to binding arbitration (see §14.2). Condition 14 of the 2006 ALTA owner's policy and Condition 13 of the 2006 ALTA lender's policy raise that threshold to $2 million (see Apps J and L). Condition 8 in the 1987 Residential policy and the 1998 CLTA/ALTA Homeowner's policy and Condition 11 in the 2003 and 2008 CLTA/ALTA Homeowner's policies permit either party to demand binding arbitration, regardless of the amount in dispute. Anecdotal reports indicate that some title insurers rarely fail to elect arbitration, while others make this determination on a case-by-case basis.

Counsel representing insureds must determine whether arbitration or litigation would be more beneficial to the insured and, if litigation would be more beneficial, whether it is possible to avoid arbitration if the insurer elects to arbitrate. To give knowledgeable advice to the client on this issue, counsel representing insureds must become familiar with arbitration procedures and the differences between arbitration and litigation of title disputes.

The increasing use of arbitration and early settlement discussions in recent years has resulted in fewer reported California appellate and supreme court decisions addressing title insurance than in previous years. Although this may appear to reflect an undue advantage for insurers (who may have considerable experience with title policy arbitrations), such experience may not prove to be much of an advantage because:

- The arbitration will be governed by rules (see §14.13) that are familiar to most practitioners, or easily learned;
- Arbitrators have considerable discretion with regard to virtually every aspect of the arbitration process, from the order of the proceedings to the admissibility of evidence to the type of remedy; and
- Prior decisions in other title arbitrations are not reported and cannot be relied on as binding precedent.

PRACTICE TIP: Advocates of title policy arbitration, like advocates of contractual arbitration in general, contend that arbitration provides a quicker and more economical resolution of disputes. Depending on the facts of the case, however, arbitration may be just as complicated, take just as long, and be just as expensive as a court trial:

- If a panel of three arbitrators is used, finding an open date for the hearing on the calendars of all the arbitrators, counsel for the parties, and experts and other witnesses may be as difficult as scheduling a courtroom.
- An arbitration hearing may occasionally be no shorter than a court trial. See, *e.g.*, *Advanced Micro Devices, Inc. v Intel Corp.* (1994) 9 C4th 362, 369, 36 CR2d 581 (arbitration lasted four and a half years and included 355 days of hearings).
- Costs for investigation, formal discovery, and administration, and per diem expenses and fees of arbitrators, may make arbitration less economical than a court trial. See, *e.g.*, *Lesser Towers, Inc. v Roscoe-Ajax Constr. Co.* (1969) 271 CA2d 675, 677 n1, 77 CR 100 (arbitration involved 202 days of testimony over 19 months, with 25,000 pages of transcript, 1500 exhibits, and over $400,000 in arbitration costs, exclusive of attorney fees).

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II. ISSUES SUBJECT TO ARBITRATION

§14.2 A. "Broad Form" Arbitration Clause in Standard Title Policy

The 1990 CLTA standard coverage policy (CLTA policy; see §6.7) provides for arbitration of all claims "arising out of or relating to" the title policy. Condition 13 of that policy states:

> 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 of 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.

Identical language is found in Condition 13 of the 1992 ALTA lender's policy (see §6.8) and Condition 14 of the 1992 ALTA owner's policy (see §6.10). Condition 8 of the 1987 Residential policy and the 1998 CLTA/ALTA Homeowner's policy (Condition 11 in the 2003 and 2008 CLTA/ALTA Homeowner's policies) provides for arbitration of "any matter in dispute" between the parties. See also §14.13.

The 2006 ALTA owner's and lender's policies similarly provide for arbitration of all claims "arising out of or relating to" the title policy. Condition 14 of the 2006 ALTA owner's policy and Condition 13 of the 2006 ALTA lender's policy state:

> Either the Company or the Insured may demand that the claim or controversy shall be submitted to arbitration pursuant to the Title Insurance Arbitration Rules of the American Land Title Association ("Rules"). Except as provided in the Rules, there shall be no joinder or consolidation with claims or controversies of other persons. 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 in connection with its issuance or the breach of a policy provision, or to any other controversy or claim arising out of the transaction giving rise to this policy. All arbitrable matters when the Amount of Insurance is $2,000,000 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 $2,000,000 shall be arbitrated only when agreed to by both the Company and the Insured. Arbitration pursuant to this policy and under the Rules shall be binding upon the parties. Judgment upon the award rendered by the Arbitrator(s) may be entered in any court of competent jurisdiction.

NOTE: Each of the standard policies refers to the Title Insurance Arbitration Rules (TIARs), which were amended in 1987, 2000, and 2006. The 1987 and 2000 TIARs incorporate the Commercial Arbitration Rules and Mediation Procedures (CARs) of the American Arbitration Association (AAA), and the 2000 TIARs state that in the event of a variance between the 2000 TIARs and the CARs, the TIARs take precedence. The 2006 TIARs, on the other hand, incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). In 2000, the American Arbitration Association (AAA) announced that it would discontinue use of the TIARs, and that its future arbitrations would be conducted using the CARs. The American Land Title Association (ALTA) continues to use the TIARs. On the differences between these sets of rules, see §14.13.

Thus, each policy contains a "broad form" arbitration agreement, in that they provide for arbitration of any controversy or claim between the title company and the insured. The CLTA policy provides for arbitration of any controversy or claim between the title 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." Such a broad form

provision includes both breach of insurance contract and, at a minimum, policy-related tort claims, such as breach of the covenant of good faith and fair dealing. For example, in *Vianna v Doctors' Mgmt. Co.* (1994) 27 CA4th 1186, 1188, 33 CR2d 188, an employment contract required arbitration of "any dispute of any kind whatsoever, regarding the meaning, interpretation or enforcement" of the contract. The court held that this was a broad form provision requiring arbitration of both contract claims as well as tort claims, including termination in violation of public policy, breach of the implied covenant of good faith and fair dealing, negligent infliction of emotional distress, and defamation.

See also *EFund Capital Inv. Partners v Pless* (2007) 150 CA4th 1311, 59 CR3d 340 (agreement to arbitrate "any dispute or other agreement arising from or out of" agreement required investor to arbitrate tort claims because agreement established and governed investor's relationship with company, and disputes would not have arisen had company never entered into agreement); *Wolitarsky v Blue Cross* (1997) 53 CA4th 338, 348, 61 CR2d 629 (fraud, bad faith, and gender discrimination claims arbitrable under health insurance policy clause to arbitrate any dispute "regarding the decision" of insurer); *Blatt v Farley* (1990) 226 CA3d 621, 628, 276 CR 612 (claims for "unsuitable investment recommendations, misrepresentations and omissions in connection with the sale of securities" embraced by clause requiring arbitration of "all disputes arising out of or relating to" investment counseling agreement); *Izzi v Mesquite Country Club* (1986) 186 CA3d 1309, 1315, 231 CR 315 (real estate purchase contract requiring arbitration of actions brought "in connection with" the contract included nondisclosure tort theories against vendors); *Bos Material Handling, Inc. v Crown Controls Corp.* (1982) 137 CA3d 99, 106, 186 CR 740 (clause in dealer agreement for arbitration of any controversy or claim "arising out of or relating to this agreement, or the breach thereof" held applicable to "all controversies, including tort claims, arising out of their contractual relationship"); *Merrick v Writer's Guild, Inc.* (1982) 130 CA3d 212, 219, 181 CR 530 (collective bargaining agreement requiring arbitration of disputes "concerning the interpretation of any of the terms" of the agreement precluded lawsuit for malicious prosecution and abuse of process arising out of prior arbitration); *Berman v Dean Witter & Co.* (1975) 44 CA3d 999, 1003, 119 CR 130 ("any controversy arising out of or relating to this contract" applies to tort actions against stockbroker for negligence and breach of fiduciary duty, which theories "have their roots in the relationship" created by the contract); *Lewsadder v Mitchum, Jones & Templeton, Inc.* (1973) 36 CA3d 255, 259, 111 CR 405 ("any controversy… arising out of my employment" includes intentional torts of libel and fraud).

In contrast, a "narrow form" arbitration provision generally applies only to contract claims "arising out of" the agreement, but not to tort claims. See *Medical Staff of Doctors Med. Ctr. v Kamil* (2005) 132 CA4th 679, 33 CR3d 853 (arbitration clause regarding disputes "concerning the terms of the agreement" between physician and insurance provider did not extend to claims for defamation and violation of Bus & P C §2056 prohibiting retaliation for advocating medically appropriate health care); *Cobler v Stanley, Barber, Southard, Brown & Assoc.* (1990) 217 CA3d 518, 530, 265 CR 868 (arbitrator exceeded jurisdiction by awarding tort damages for emotional distress when contract only required arbitration for "a dispute arising from this Agreement"); *Mansdorf v California Physicians' Serv.* (1978) 87 CA3d 412, 417, 151 CR 388 (arbitration contract between insured and insurer "with respect to any of the terms, conditions, or benefits of this agreement" not applicable to tortious bad faith claim); *Tracer Research Corp. v National Environmental Serv. Co.* (9th Cir 1994) 42 F3d 1292, 1295 (marketing license contract's requirement for arbitration of any controversy or claim "arising out of" the contract not applicable to tort of misappropriation of trade secrets).

In view of the broad language of the standard coverage policies, a court is likely to determine that any claims based on breach of the title insurance contract, as well as tort claims for breach of the implied covenant of good faith and fair dealing, are subject to binding arbitration.

If the title insurer also acts as the escrow agent for the transaction, is a claim arising out of the escrow services subject to arbitration under the provisions of the title policy? The authors know of no authority on point. To avoid arbitration, a party might reason that the title insurer's obligations as insurer are separate and distinct from its obligations as the escrow agent. See *Contini v Western Title Ins. Co.* (1974) 40 CA3d 536, 545, 115 CR 257, discussed in §11.47. The insured may argue that the lack of an arbitration clause in the escrow instructions does not bind the insured to arbitration because the title company was acting in another capacity as escrow agent.

A party in favor of arbitration under the CLTA or ALTA policies might rely on the fact that the arbitration clause expressly extends to any claim or controversy arising from "any service of the Company" in connection with the issuance of the title policy "or the breach of [any] other obligation." A party in favor of arbitration under the 1987 Residential policy or the 1998 Homeowners policy might rely on the fact that the arbitration clause extends to "any matter in dispute" between the insurer and insured. The scope of this language has not been precisely ascertained, but

it could arguably extend to include any dispute between the parties. On joinder of parties, see §§14.12, 14.23. On consolidation of arbitrations, see §14.24. For discussion of enforcement of the arbitration clause, see §§14.5-14.11.

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§14.3 B. Arbitrable Issues Determined by Court Rather Than Arbitrator

A court must generally decide whether a party is bound to arbitrate and which issues it must arbitrate. *Bouton v USAA Cas. Ins. Co.* (2008) 43 C4th 1190, 1199, 78 CR3d 519, overruling *Van Tassel v Superior Court* (1974) 12 C3d 624, 627, 116 CR 505 (which had held that an arbitrator may decide "jurisdictional facts," including the status of the claimant as an insured); CCP 1281.2. In determining which issues are subject to arbitration, the court necessarily must examine and, to some extent, interpret the underlying agreement. *Freeman v State Farm Mut. Auto. Ins. Co.* (1975) 14 C3d 473, 480, 121 CR 477; *State Farm Mut. Auto. Ins. Co. v Superior Court* (1994) 23 CA4th 1297, 1301, 28 CR2d 711. Unless the agreement clearly and unmistakably states the contrary, whether the parties agreed to arbitrate the particular matter in dispute must be decided by the court rather than the arbitrator. *Litton Fin. Printing Div. v NLRB* (1991) 501 US 190, 208, 115 L Ed 2d 177, 198, 111 S Ct 2215; *Parker v Twentieth Century Fox Films Corp.* (1981) 118 CA3d 895, 901, 173 CR 639.

NOTE: Nothing in the CLTA standard coverage policy or the ALTA policies expressly states that the arbitrator will decide which issues are arbitrable. The 2006 version of the National Arbitration Forum's Code of Procedure ("COP") Rule 20(E) states that an arbitrator has the power to rule on "objections relating to the existence, scope, and validity of the arbitration agreement, including all objections relating to jurisdiction, unconscionability, contract law, and enforceability of the arbitration agreement." Presumably, this extends to defenses to arbitration, but not to what issues were arbitrable. The 2007 and 2008 versions of COP Rule 20(F) add an express statement that an arbitrator has the power to rule on "questions of arbitrability." No case has yet determined whether this new provision will constitute a "clear and unmistakable" agreement that the arbitrator, and not the court, will decide what issues may be arbitrated. See *Litton Fin. Printing Div. v NLRB, supra*; *Parker v Twentieth Century Fox Films Corp.,* 118 CA3d at 901.

In other respects, the court's role in adjudicating disputes covered by binding contractual arbitration is limited. See California Civil Procedure Before Trial §§5.16-5.17 (4th ed Cal CEB 2004).

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§14.4 C. Provisional Remedies Not Arbitrable

Although the 2006, 2007, and 2008 versions of the Code of Procedure of the National Arbitration Forum state that a party may seek a temporary restraining order or a preliminary injunction (COP Rule 27(D)) and may grant any "legal, equitable or other remedy or relief provided by law" (COP Rule 20(D)), under California law, arbitrators do not have the statutory authority to grant provisional remedies (*e.g.,* injunctive relief, writs of attachment or possession, appointment of receivers, temporary protective orders) pending the arbitration process. See CCP §1281.8; *Boughton v Cigna Healthplans* (1999) 21 C4th 1066, 1079, 90 CR2d 334; *Warren-Guthrie v Health Net* (2000) 84 CA4th 804, 817, 101 CR2d 260, disapproved on other grounds in *Cronus Invs., Inc. v Concierge Servs.* (2005) 35 C4th 376, 383 n8, 25 CR3d 540; *Marsch v Williams* (1994) 23 CA4th 238, 245, 28 CR2d 402. It is not possible for the parties to stipulate to the arbitrator's granting or ordering a provisional remedy; such power can be conferred on the arbitrator only by the legislature. 23 CA4th at 248.

Under CCP §1281.8(b), the party applying for the provisional remedy must demonstrate to the court that the award to which the party may be entitled in the arbitration "may be rendered ineffectual without provisional relief." This is a minimum prerequisite; the party must also meet any statutory and common-law requirements for the particular remedy. See *Davenport v Blue Cross* (1997) 52 CA4th 435, 450, 60 CR2d 641; *Wooley v Embassy Suites, Inc.* (1991) 227 CA3d 1520, 1529, 278 CR 719.

The application must also be accompanied by a complaint or a copy of the demand for arbitration and any response to the demand. If a complaint is filed with the application, the applicant must state whether the right to compel arbitration is reserved. CCP §1281.8(b). On waiver of the right to compel arbitration, see §14.11.

PRACTICE TIP: A party applying for provisional relief, who also wishes to retain the right to compel arbitration of any related arbitrable dispute, should always present to the court at the same time an additional application to stay (pending the arbitration) all other proceedings in the lawsuit underlying the request for provisional relief. See CCP §1281.8(d).

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III. ENFORCING AND RESISTING ARBITRATION

§14.5 A. Compelling Arbitration by Petition

Generally, a petition to compel arbitration is the method used to enforce an arbitration clause when one party refuses to arbitrate on the demand of the other. CCP §1281.1. In title insurance cases involving the CLTA policy, the 1992 ALTA lender's policy, or the 1992 ALTA owner's policy, in which the policy limit is greater than $1 million, a petition to compel arbitration would be futile because binding arbitration is not required in such cases without the mutual consent of both the insured and the insurer.

However, under the CLTA or either 1992 ALTA policy, if the policy limit is $1 million or less and either the insurer or the insured demands arbitration, then arbitration is mandatory and binding. The 2006 ALTA owner's and lender's policies raise that threshold to $2 million.

Under the 1987 Residential policy or the 1998 Homeowners policy, arbitration is mandatory and binding regardless of the policy limit. In such cases, if one party refuses to submit the dispute to arbitration, the other party will have to petition the court to enforce the arbitration provision.

If a suit between the insured and the insurer is already pending, the party seeking to compel arbitration may file a motion to compel arbitration in lieu of an answer in that action. CCP §1281.7. As an alternative, whether or not a lawsuit is already pending on the arbitrable issues, that party may file a petition to compel arbitration. CCP §§1281.2, 1290. If a suit is already pending between the parties, the motion or petition to compel arbitration should be accompanied by a motion to stay prosecution of the litigation. CCP §1281.4.

A petition or motion to compel arbitration is a summary proceeding. "A proceeding to compel arbitration is in essence a suit in equity to compel specific performance of a contract." *Freeman v State Farm Mut. Auto. Ins. Co.* (1975) 14 C3d 473, 479, 121 CR 477; *Brodke v Alphatec Spine Inc.* (2008) 160 CA4th 1569, 1574, 73 CR3d 554. Under CCP §1281.2(a)-(c),

> [o]n petition of a party to an arbitration agreement alleging the existence of a written agreement to arbitrate a controversy and that a party thereto refuses to arbitrate such controversy, the court shall order the petitioner and the respondent to arbitrate the controversy if it determines that an agreement to arbitrate the controversy exists, unless it determines [there is a defense to enforcing the agreement].

The party seeking to compel arbitration must allege the existence of a valid agreement to arbitrate. *Spear v California State Auto. Ass'n* (1992) 2 C4th 1035, 1041, 9 CR2d 381; *Brodke v Alphatec Spine Inc., supra*. For example, in *Brodke*, the plaintiffs attached a copy of a contract containing an arbitration provision. The defendants did not allege the existence of an agreement to arbitrate but rather alleged that plaintiffs alleged the existence of such an agreement to arbitrate, while defendants contested the existence or validity of such an agreement. 160 CA4th at 1572. The trial court granted the defendants' petition to compel arbitration. 160 CA4th at 1573. The appellate court held that the petition had to be denied because the defendants did not adequately allege the existence of an agreement to arbitrate.

Further, the party seeking to compel arbitration has the burden of proving the existence of a valid arbitration agreement; this may be done through submitting a copy of the agreement or through other competent evidence of the terms of the agreement. Cal Rules of Ct 3.1330; *Engalla v Permanente Med. Group* (1997) 15 C4th 951, 972, 64 CR2d 843; *Larian v Larian* (2004) 123 CA4th 751, 760, 19 CR3d 916; *Condee v Longwood Mgmt. Corp.* (2001) 88 CA4th 215, 219, 105 CR2d 597. See also *Brodke v Alphatec Spine Inc.* (2008) 160 CA4th 1569, 1572, 73 CR3d 554 (evidence offered by defendants, consisting solely of counsel's declaration attaching copy of plaintiff's complaint and contract attached to it, was insufficient to prove existence of written agreement to arbitrate). The party opposing arbitration must prove any fact necessary to prevent enforcement. *Engalla v Permanente Med. Group, supra*. In *Coast Plaza Doctors Hosp. v Blue Cross* (2000) 83 CA4th 677, 686, 99 CR2d 809, the court held that the party opposing arbitration has the burden of establishing that the arbitration clause cannot be interpreted to require arbitration of the dispute. Any doubts on whether an arbitration clause applies to a particular dispute should be resolved in favor of requiring the parties to arbitrate. *Larian,* 123 CA4th at 759; *Vianna v Doctors' Mgmt. Co.* (1994) 27 CA4th 1186, 1189,

33 CR2d 188. Facts necessary to determine the arbitration agreement's enforceability are shown through affidavits or declarations. *Condee v Longwood Mgmt. Corp., supra*. The court must conduct a summary hearing "in the manner… provided by law for the… hearing of motions." CCP §1290.2. The trial court must resolve all factual disputes; a jury trial is not available. *Engalla v Permanente Med. Group, supra*; *Rosenthal v Great W. Fin. Sec. Corp.* (1996) 14 C4th 394, 413, 58 CR2d 875.

If the court determines the agreement to arbitrate exists, it should then decide objections to its enforceability. Once the court has determined the agreement exists, the court must grant the petition "unless it determines that: [¶] (a) The right to compel arbitration has been waived by the petitioner; or [¶] (b) Grounds exist for the revocation of the agreement." CCP §1281.2; *Larian v Larian*, *supra*; *Condee v Longwood Mgmt. Corp., supra*. For procedures to follow in seeking to compel arbitration and in appealing related court orders, see California Civil Procedure Before Trial §§5.13-5.36 (4th ed Cal CEB 2004).

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§14.6 B. Opposing Arbitration

Despite the purported advantages of arbitration, the first thought of many attorneys faced with binding contractual arbitration is how to avoid it. Title insurers may be amenable to removing the arbitration clause when issuing a title policy, particularly for lenders. If, however, the clause was not the subject of negotiation when the policy was issued, a number of statutory defenses under CCP §1281.2 and a plethora of cases provide opportunity for an insured to oppose arbitration of a title insurance dispute. Available defenses include:

- Unenforceability of the arbitration agreement (see §§14.7-14.10);
- Waiver of right to compel arbitration (see §14.11); and
- Pending litigation with third parties that might produce inconsistent results (see §14.12).

Procedurally, a party who wishes to avoid the arbitration process may directly oppose a petition to compel the arbitration by filing a response within 10 days after being served with the petition. CCP §1290.6. The opposing party bears the burden of proving any fact necessary to defend against enforcement of the arbitration agreement. See §14.5. See also *Engalla v Permanente Med. Group* (1997) 15 C4th 951, 972, 64 CR2d 843; *Larian v Larian* (2004) 123 CA4th 751, 760, 19 CR3d 916. In cases in which the party desiring to arbitrate has already initiated the arbitration process, the opposing party may request an injunction to stay the arbitration until the arbitrability issues are resolved. *California State Council of Carpenters v Superior Court* (1970) 11 CA3d 144, 152, 89 CR 625.

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Source: Real Property/California Title Insurance Practice/14 Arbitration Procedures/ 1. Unenforceability of Arbitration Clause/§14.7 a. Lack of Informed Consent

1. Unenforceability of Arbitration Clause

§14.7 a. Lack of Informed Consent

In the usual title insurance transaction, the insured does not receive a title policy until after the escrow has closed. The insured does receive a preliminary report, which sets forth the exceptions and exclusions from coverage but may not refer to arbitration. The 1995 preliminary report form (see App C), for example, states only that the

> printed Exceptions and Exclusions from the coverage of said Policy or Policies are set forth in Exhibit A attached. Copies of the Policy forms should be read. They are available from the office which issued this report.

The 2004 CLTA preliminary report form (see App D) similarly does not refer to arbitration.

If these forms are used, an insured under a title insurance policy might argue a lack of informed consent to establish that the insured never agreed to the arbitration provision. See CCP §1281.2(b). Such an argument might be based on the insured's complete ignorance of the arbitration provision until the policy was delivered after the close of escrow.

Under California contract principles, a contract may validly incorporate the provisions of a document that is not physically part of the basic contract, but under the ruling of *Chan v Drexel Burnham Lambert* (1986) 178 CA3d 632, 637, 223 CR 838:

- The reference to the other document must be clear and unequivocal;
- The reference must be called to the attention of the other party, who must consent to it; and
- The terms of the incorporated document must be known or easily available to the contracting parties.

In *Chan*, an employee of a stock brokerage firm signed an employment agreement in which the employee agreed to abide by the rules and bylaws of the New York Stock Exchange, which require arbitration of disputes between member firms and their employees. The *Chan* court applied California contract principles to determine whether the rule requiring arbitration was incorporated into the employment contract. Noting that the right to select a judicial forum is a substantial right, the *Chan* court held that because the employment contract did not clearly and unequivocally refer to the incorporated document, the arbitration provision was not incorporated into the employment contract.

The court in *Wolschlager v Fidelity Nat'l Title Ins. Co.* (2003) 111 CA4th 784, 4 CR3d 179, however, distinguished *Chan* and held that the preliminary title report sufficiently incorporated the arbitration clause by reference. The court reasoned that, unlike *Chan,* in which the document signed by the appellant referred generally to a number of different documents incorporated by reference, the preliminary report specifically identified the document incorporated as the policy, listed the form that was contemplated, and told the recipients where they could find the policy. The *Wolschlager* court held that the incorporation of the policy was both clear and unequivocal. The court further held that the insurer was not required to specify that the incorporated document contain an arbitration provision. The plaintiff was bound by the arbitration provision, even if he lacked knowledge of it, because the preliminary report identified the policy by name and directed the plaintiff to where he could inspect it. 111 CA4th at 791.

In *Kleveland v Chicago Title Ins. Co.* (2006) 141 CA4th 761, 46 CR3d 314, the preliminary report issued by the title company did not include arbitration, but indicated that an ALTA policy (which would contain an arbitration provision) would be issued. However, a CLTA policy (containing a virtually identical arbitration provision) was issued. The plaintiffs argued that they could not be bound to an arbitration provision that was not either contained in the preliminary report or incorporated by reference. The appellate court, distinguishing *Wolschlager*, agreed, holding that it was "unreasonable to rely on an arbitration clause in a nonexistent policy to deny plaintiffs the right to a jury trial." 141 CA4th at 765.

The 2006 CLTA preliminary report form contains the following provision:

> The policy to be issued may contain an arbitration clause. When the Amount of Insurance is less than that set forth in the arbitration clause, all arbitrable matters shall be arbitrated at the option of either the Company or the Insured as the exclusive remedy of the parties.

No reported decisions have interpreted this provision. However, it would appear that this provision will make it far more

difficult for an insured to argue lack of informed consent.

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Source: Real Property/California Title Insurance Practice/14 Arbitration Procedures/§14.8 b. Adhesionary Contract; Unconscionability

§14.8 b. Adhesionary Contract; Unconscionability

Insureds seeking to avoid arbitration under a title insurance policy may assert that the policy is a contract of adhesion and that the arbitration provision is unconscionable. Unconscionability analysis begins with inquiring into whether the contract is one of adhesion. *Armendariz v Foundation Health Psychcare Servs.* (2000) 24 C4th 83, 103, 99 CR2d 745; see also *Sixells, LLC v Cannery Bus. Park* (2008) 170 CA4th 648, 655, 88 CR3d 235. "The term [contract of adhesion] signifies a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." If the contract is adhesive, the court must then decide whether "other factors are present which, under established legal rules—legislative or judicial—operate to render it [unenforceable]." 24 C4th at 103. Generally speaking, there are two judicially imposed limitations on the enforcement of adhesion contracts or their provisions. The first is that such a contract or provision that does not fall within the reasonable expectations of the weaker or "adhering" party will not be enforced against that party. The second—a principle of equity applicable to all contracts generally—is that a contract or provision, even if consistent with the parties' reasonable expectations, will be denied enforcement if, considered in its context, it is unduly oppressive or unconscionable. Case law refers to both the "reasonable expectations" and the "oppressive" limitations as being aspects of unconscionability.

Unconscionability has both a procedural and a substantive element, the former focusing on "oppression" or "surprise" owing to unequal bargaining power, the latter on "overly harsh" or "one-sided" results. *Armendariz*, 24 C4th at 114. See also, *Gentry v Superior Court* (2007) 42 C4th 443, 468, 64 CR3d 773. "The prevailing view is that [procedural and substantive unconscionability] must *both* be present in order for a court to exercise its discretion to refuse to enforce a contract or clause under the doctrine of unconscionability." *Gentry*, 42 C4th at 469. But they need not be present in the same degree. Essentially, a sliding scale is invoked that disregards the regularity of the procedural process of the contract formation, that creates the terms, in proportion to the greater harshness or unreasonableness of the substantive terms themselves. In other words, the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa. *Armendariz*, 24 C4th at 114; *Gentry v Superior Court, supra*.

The authors are aware of no California cases that have decided whether arbitration provisions in standard language title insurance policies are unconscionable. Arguments that arbitration provisions are unconscionable and thus unenforceable have met with mixed success in California courts on other types of contracts. Some courts have held that "reasonable and fair" arbitration provisions are enforceable, even if they are contained in contracts of adhesion. See *Engalla v Permanente Med. Group* (1997) 15 C4th 951, 985, 64 CR2d 843; *Graham v Scissor-Tail, Inc.* (1981) 28 C3d 807, 819, 171 CR 604; *Craig v Brown & Root, Inc.* (2000) 84 CA4th 416, 422, 100 CR2d 818; *Bos Material Handling, Inc. v Crown Controls Corp.* (1982) 137 CA3d 99, 108, 186 CR 740. Other courts have refused to enforce provisions that are "unconscionably one-sided and unfair" (see *Gentry v Superior Court* (2007) 42 C4th 443, 470, 64 CR3d 773; *Armendariz v Foundation Health Psychcare Servs., supra*; *Bolter v Superior Court* (2001) 87 CA4th 900, 909, 104 CR2d 888; *Pinedo v Premium Tobacco Stores, Inc.* (2000) 85 CA4th 774, 781, 102 CR2d 435; *Kinney v United Healthcare Servs., Inc.* (1999) 70 CA4th 1322, 1332, 83 CR2d 348; *Stirlen,* 51 CA4th at 1522) or that appear to be bilateral but are actually unjust to one side (see *Fitz v NCR Corp.* (2004) 118 CA4th 702, 725, 13 CR3d 88; *Saika v Gold* (1996) 49 CA4th 1074, 1079, 56 CR2d 922).

In an effort to preserve the rights of parties to choose contractual arbitration, some courts refuse to enforce only the offending provisions and uphold the provisions of the arbitration agreement that are just and reasonable. For example, in *Graham v Scissor-Tail, Inc.* (1981) 28 C3d 807, 831, 171 CR 604, the supreme court invalidated an arbitration provision as unconscionable because it provided for the selection of an arbitrator likely to be biased in favor of one party. However, the court invalidated only the provision on the selection of the arbitrator. The court then held that, because CCP §1281.6 provided for a "default" method of selecting the arbitrator when the parties could not agree, the remainder of the arbitration provision could be enforced, with the trial court appointing an arbitrator if the parties did not agree. *Graham v Scissor-Tail, Inc., supra*. See also *Bolter v Superior Court* (2001) 87 CA4th 900, 910, 104 CR2d 888;

Saika v Gold (1996) 49 CA4th 1074, 56 CR2d 922; *Benyon v Garden Grove Med. Group* (1980) 100 CA3d 698, 708, 161 CR 146.

However, in *Armendariz v Foundation Health Psychcare Servs.* (2000) 24 C4th 83, 127, 99 CR2d 745, the supreme court held that, when the arbitration provision is "permeated" with unconscionable provisions, the entire arbitration provision is unenforceable. The *Armendariz* court held that the existence of multiple offensive provisions indicated, "a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage." 24 C4th at 124. The court noted that any contrary rule would encourage overreaching by the party drafting the arbitration provision. See also *Fitz v NCR Corp.* (2004) 118 CA4th 702, 727, 13 CR3d 88; *Pinedo v Premium Tobacco Stores, Inc.* (2000) 85 CA4th 774, 780, 102 CR2d 435.

To avoid the potential defenses to enforceability in California law, a title insurer may argue that title policies are contracts affecting interstate commerce. See *McLain v Real Estate Bd.* (1980) 444 US 232, 62 L Ed 2d 441, 100 S Ct 502 (transaction between residential home buyer and real estate broker affects interstate commerce). If title policies do affect interstate commerce, title insurers can seek to enforce an arbitration provision under the Federal Arbitration Act (9 USC §§1-16).

Although state adhesionary contract principles do not apply to enforcement of arbitration clauses governed by the Federal Arbitration Act, the formation of a valid agreement to arbitrate is governed by California contract law. *Chan v Drexel Burnham Lambert* (1986) 178 CA3d 632, 637, 223 CR 838. See §14.7. Furthermore, the Federal Arbitration Act does not prohibit a court from finding that an arbitration clause is unconscionable under state law. *Stirlen v Supercuts, Inc., supra*.

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§14.9 c. Rescission Based on Fraud

Under CCP §1281.2(b), a court may deny a petition to compel arbitration when there are grounds, such as fraud, for rescinding the agreement to arbitrate. *Engalla v Permanente Med. Group* (1997) 15 C4th 951, 973, 64 CR2d 843.

California law distinguishes between fraud in the execution or inception of a contract versus fraud in the inducement to contract. The former relates to the inception or execution of the agreement, so that the promisor is deceived as to the nature of its act, and actually does not know what it is signing, or does not intend to enter into a contract at all; mutual assent is lacking, and the contract is void ab initio. The court should deny the petition to compel arbitration. In contrast, fraud in the inducement occurs when the promisor knows what it is signing but its consent is induced by fraud. Mutual assent is present and a contract is formed, which, by reason of the fraud, is voidable. To escape from its obligations, the aggrieved party must rescind the contract. *Rosenthal v Great W. Fin. Sec. Corp.* (1996) 14 C4th 394, 415, 58 CR2d 875; *Larian v Larian* (2004) 123 CA4th 751, 761, 19 CR3d 916. However, by entering into the arbitration agreement, the parties established their intent that disputes coming within the agreement's scope be determined by an arbitrator, rather than a court. *Rosenthal*, 14 C4th at 416; *Larian*, 123 CA4th at 762. Thus, fraud in the inducement will not preclude arbitration, and the supreme court declined to determine whether such fraud, if proven, can form the basis for equitable or other relief in arbitration. See *Rosenthal,* 14 C4th at 423; *Larian*, 123 CA4th at 764.

In *Engalla v Permanente Med. Group*, *supra,* the defendants engaged in delay tactics by, among other things, failing to respond and imposing extracontractual conditions in selecting the arbitrator, after representing in the policy, newsletters, and other sources that the arbitration process was speedy and efficient. This conduct was sufficient to support a theory of promissory fraud in the inducement of the agreement to arbitrate. 15 C4th at 981. Although the supreme court in *Engalla* referred to fraudulent inducement, the appellate court in *Larian v Larian*, *supra* indicated that court's belief that the supreme court was actually referring to fraud in the execution or inception. 123 CA4th at 764.

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Source: Real Property/California Title Insurance Practice/14 Arbitration Procedures/§14.10 d. Rescission Based on Other Grounds

§14.10 d. Rescission Based on Other Grounds

In *Engalla v Permanente Med. Group* (1997) 15 C4th 951, 973, 64 CR2d 843, the supreme court construed CCP §1281.2(b) to require a trial court to deny a petition to compel arbitration "when there are grounds for rescinding" the arbitration agreement. The grounds for rescission stated in CC §1689 and the applicable statutes referenced in CC §1689(b)(7) are all potentially available to a party seeking to oppose a petition to arbitrate:

- Mutual consent was given to the rescission;
- Consent to the agreement was given by mistake or obtained by duress, menace, fraud, or undue influence (see §14.7);
- A failure of consideration was caused by the party against whom rescission is sought;
- Consideration for the obligations of the rescinding party is void for any cause;
- Consideration for the obligations of the rescinding party fails in a material respect from any cause, before consideration is rendered;
- The contract is unlawful for causes not appearing in the terms or conditions, and the parties are not equally at fault;
- The contract is void as against public policy;
- The rescinding party is of unsound mind (see CC §39);
- The nonrescinding party has breached a material warranty or other material term of the insurance policy (see Ins C §447);
- An affirmative or promissory material fact was falsely represented by the nonrescinding party (see Ins C §359);
- There was an intentional and fraudulent omission relating to a material fact by the nonrescinding party (see Ins C §338); and
- There was intentional or unintentional concealment of a material fact by the nonrescinding party (see Ins C §331).

NOTE: Application of any of these theories requires the party opposing a petition to compel arbitration to show that the asserted theory relates specifically to the agreement to arbitrate rather than to the contract in general. *Engalla v Permanente Med. Group, supra*.

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§14.11 2. Waiver of Agreement to Arbitrate

A party seeking to avoid arbitration under a title insurance policy may also examine whether there is any basis to establish that the other party has waived the arbitration provision in the policy. See CCP §1281.2(a). Waiver may arise from a number of different circumstances.

Use of the term "waiver" in the context of a waiver of arbitration rights does not necessarily mean that the party has intentionally relinquished such rights. In *Platt Pac., Inc. v Andelson* (1993) 6 C4th 307, 314, 24 CR2d 597, the supreme court explained that decisions concerning loss of arbitration rights use the word "waiver" in the sense of the loss or forfeiture of a right resulting from failure to perform a required act.

In *Davis v Blue Cross* (1979) 25 C3d 418, 426, 158 CR 828, for example, the California Supreme Court held that Blue Cross waived its right to compel arbitration by breaching its covenant of good faith and fair dealing in failing to inform claimants of the right to arbitration at the time Blue Cross denied coverage on the claim. In affirming the trial court order denying Blue Cross's petition to compel arbitration, the supreme court held that one aspect of the insurer's duty of good faith is the duty to reasonably inform an insured of the insured's rights and obligations under the insurance policy. The court stated that in situations in which an insured's lack of awareness may potentially result in a loss of benefits or a forfeiture of rights, "an insurer has been required to bring to the insured's attention relevant information so as to enable the insured to take action or secure rights afforded by the policy." 25 C3d at 428.

The *Davis* court found the arbitration provision to be obscurely placed and ambiguous because it was buried in the fine print of the policy and there was no heading, boldface type, or larger print to draw the insured's attention to it. The opinion further stated that the trial court's finding that the average insured would not know of a right to arbitration buried in an obscure provision of a policy, unless informed, "squares with common experience" and that without advice the average policyholder "is not likely to be aware of a potential arbitration remedy or the means of initiating such a procedure." 25 C3d at 429.

In *Wolschlager v Fidelity Nat'l Title Ins. Co.* (2003) 111 CA4th 784, 4 CR3d 179, the title insurer did not inform the insured of the existence of the arbitration provision during a long claims and negotiation process. Moreover, when the insurer denied coverage for the claim, the denial letter advised the insured of his right to seek redress with the Department of Insurance, but failed to make any mention of the right to arbitrate. Further, when the insured filed suit, the insurer did not raise the arbitration provision as an affirmative defense, but instead answered the complaint. The insurer did not demand arbitration until the insured propounded his first set of discovery requests. The trial court found that the insurer waived the right to arbitrate. Citing the totality of the circumstances, the appellate court reversed, explaining, "[s]ince [the insurer] did not substantively engage in the litigation process, there was no evidence of any appreciable prejudice to the plaintiff." 111 CA4th at 793. The appellate court referred to the insurer's conduct as "somewhat questionable," but noted that the arbitration clause was presented in bold in a document that was both properly incorporated by reference into the agreement and actually in the plaintiff's possession at the time he filed his claim. The appellate court distinguished prior cases in which the insured was unaware of his or her arbitration rights, noting that, during the claims process, the insured was represented by counsel who admitted knowing about the arbitration provision.

California courts have found a waiver of the right to compel arbitration in a variety of contexts, including the following:

- A party who received and accepted the benefits of an arbitration award, failed to file a petition to vacate or correct the award, and then petitioned to confirm it waived the right to attack the award by failing to file a petition to vacate. *Louise Gardens of Encino Homeowners Ass'n v Truck Ins. Exch.* (2000) 82 CA4th 648, 658, 98 CR2d 378.
- The party opposing arbitration engaged in extensive discovery; no further showing of prejudice was required. *Berman v Health Net* (2000) 80 CA4th 1359, 96 CR2d 295.
- The party seeking to compel arbitration has previously taken steps inconsistent with an intent to invoke arbitration. See, *e.g.*, *Local 659, I.A.T.S.E. v Color Corp.* (1956) 47 C2d 189, 194, 302 P2d 294; *Case v Kadota*

Fig Ass'n (1950) 35 C2d 596, 604, 220 P2d 912; *New Linen Supply v Eastern Envt'l Controls, Inc.* (1979) 96 CA3d 810, 814, 158 CR 251; *Bodine v United Aircraft Corp.* (1975) 52 CA3d 940, 945, 125 CR 344. But see *Boys Club, Inc. v Fidelity & Deposit Co.* (1992) 6 CA4th 1266, 1275, 8 CR2d 587 (required showing of prejudice to party opposing arbitration).

- The party demanding arbitration has already filed and prosecuted a lawsuit, and the party opposing arbitration has been prejudiced by litigation of the dispute. See *Doers v Golden Gate Bridge, Highway & Transp. Dist.* (1979) 23 C3d 180, 188, 151 CR 837.
- A party fails to demand arbitration within the time period expressly provided in the contract. See *Platt Pac., Inc. v Andelson* (1993) 6 C4th 307, 318, 24 CR2d 597.
- The petitioning party unreasonably delays invoking arbitration. See *Christensen v Dewor Dev.* (1983) 33 C3d 778, 781, 191 CR 8; *Sawday v Vista Irrig. Dist.* (1966) 64 C2d 833, 836, 52 CR 1; *Brunzell Constr. Co. v Harrah's Club* (1967) 253 CA2d 764, 778, 62 CR 505.
- The party demanding arbitration is guilty of unreasonable delay tactics, bad faith, or willful misconduct. See *Engalla v Permanente Med. Group* (1997) 15 C4th 951, 984, 64 CR2d 843; *Christensen v Dewor Dev., supra*; *Davis v Blue Cross* (1979) 25 C3d 418, 426, 158 CR 828; *Local 659, I.A.T.S.E. v Color Corp.* (1956) 47 C2d 189, 196, 302 P2d 294.

No single test delineates the nature of conduct that constitutes such a waiver, and whether there has been a waiver is ordinarily a question of fact. A factual finding of waiver, if supported by sufficient evidence, is binding on the appellate court. *Davis v Blue Cross, supra*; *Sawday v Vista Irrig. Dist.* (1966) 64 C2d 833, 836, 52 CR 1. However, when the facts are undisputed and only one inference may reasonably be drawn, the issue is one of law and the reviewing court is not bound by the trial court's ruling. *Platt Pac., Inc. v Andelson* (1993) 6 C4th 307, 319, 24 CR2d 597.

A request for provisional relief from the court by a party to an arbitration agreement, accompanied by the filing of a complaint, may indicate an intent to waive the right to compel arbitration of the dispute, unless a reservation of rights is made and a stay of the lawsuit is requested. See CCP §1281.8(b)-(d), discussed in §14.4.

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Source: Real Property/California Title Insurance Practice/14 Arbitration Procedures/§14.12 3. Pending Litigation with Third Parties

§14.12 3. Pending Litigation with Third Parties

Occasionally, one or both of the parties to the arbitration agreement may also be involved in pending litigation with a third party arising out of the same transaction or a series of related transactions. If "a possibility of conflicting rulings on a common issue of law or fact" exists, a court considering a petition or motion to compel arbitration has four options under CCP §1281.2(c):

- Refusing to enforce the arbitration agreement and ordering intervention or joinder of all parties in a single action;
- Ordering intervention or joinder on all or only certain issues;
- Ordering arbitration among the parties that have agreed to arbitration and staying the pending lawsuit pending the outcome of the arbitration proceeding; or
- Staying the arbitration pending the outcome of the lawsuit.

EXAMPLE: The possibility of inconsistent rulings might arise in a title dispute if the escrow in a transaction were handled by one company and the title policy were issued by another. If the insured failed to obtain title as expected because of an error by the escrow company and the title insurer denied coverage for the claim, the insured would then face the prospect of filing a suit against the escrow company and an arbitration action against the insurer. The insured would risk the possibility of inconsistent results and the cost of prosecuting two separate proceedings.

Under CCP §1281.2, the trial court has the discretion to choose the most appropriate option given the facts and circumstances of the case. See, *e.g.*, *Prudential Prop. & Cas. Ins. Co. v Superior Court* (1995) 36 CA4th 275, 279, 42 CR2d 227 (uninsured motorist arbitration ordered joined with pending civil action); *Henry v Alcove Inv.* (1991) 233 CA3d 94, 101, 284 CR 255 (arbitration proceedings stayed pending outcome of civil action involving multiple parties); *C.V. Starr & Co. v Boston Reins. Corp.* (1987) 190 CA3d 1637, 1640, 236 CR 167 (petition to compel arbitration denied). The courts lack jurisdiction, however, to order a third party who is not a signatory to an arbitration agreement to join in the arbitration. *County of Contra Costa v Kaiser Found. Health Plan, Inc.* (1996) 47 CA4th 237, 54 CR2d 628; *Unimart v Superior Court* (1969) 1 CA3d 1039, 1045, 82 CR 249.

PRACTICE TIP: The party opposing the petition to compel should argue for one or more of the options favorable to its position along with other grounds for opposing the petition. See §§14.6-14.11. The possibility of conflicting rulings cannot be argued generally; the most successful strategy for persuading a court to order one of the choices allowed under CCP §1281.2(c) is to (a) list specifically all facts and issues on which a conflicting ruling might be made and correlate them to the pleadings in each proceeding, (b) demonstrate how other options would prejudice the party opposing arbitration, and (c) estimate the monetary expense to all parties if forced both to arbitrate and to litigate the same issues. On consolidating arbitrations, see §14.24.

Cronus Investments, Inc. v Concierge Svcs. (2005) 35 C4th 376, 25 CR3d 540, involved a dispute in which 7 out of 10 parties were not party to any arbitration agreement. The California Supreme Court held that, in such a situation, CCP §1281.2(c) allows the trial court either "to stay arbitration proceedings while the concurrent lawsuit proceeds or stay the lawsuit while arbitration proceeds to avoid conflicting rulings on common issues of fact and law" among related parties. 35 C4th at 393. The arbitration agreement in Cronus had a broad choice-of-law provision, generally incorporating California law, and also provided that the Federal Arbitration Act (FAA), 9 USC §§1-16, applied to the extent applicable. The court further held that CCP §1281.2(c) did not conflict with the FAA and did not undermine the FAA policy favoring arbitration; the FAA therefore did not preempt CCP §1281.2(c).

The arbitration provision in the CLTA policy and the 1992 ALTA lender's and owner's policies states that "[t]he law of the situs of the land shall apply to an arbitration under the Title Insurance Arbitration Rules." The arbitration provision in the 2006 ALTA lender's and owner's policies deletes that requirement, but does require that arbitration be conducted under the ALTA Title Insurance Arbitration Rules (TIARs); and TIAR Rule 7 contains such a provision. The arbitration provision in the 1987 Residential policy states that "[t]he law used in the arbitration is the law of the place where the

property is located." The arbitration provision in the 1998 Homeowners policy is nearly identical. In a title insurance case involving a multi-party dispute similar to *Cronus*, when not all of the parties are party to the arbitration agreement, the FAA should not preempt a stay of pending court litigation while the arbitration proceeds.

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IV. PREHEARING ARBITRATION PROCEDURES

§14.13 A. Applicable Rules

Condition 13 of the CLTA policy and the 1992 ALTA lender's policy, Condition 14 of the 1992 ALTA owner's policy, Condition 8 of the 1987 Residential policy, and Condition 11 of the 1998 Homeowners policy all provide that arbitration will be conducted under the Title Insurance Arbitration Rules (TIARs) of the American Arbitration Association (AAA). See §14.2. All these policies also provide that the insured may elect whether to apply the TIARs in effect on the date of the demand for arbitration (or "current" TIARs) or the TIARs in effect on the date of the policy. The most recent version of the TIARs was amended January 1, 2006; prior versions were amended January 1, 2000 and January 1, 1987. The 2006 and 2000 versions may be found at http://www.alta.org.

NOTE: The standard policies issued prior to 2006 state that the "Title Insurance Arbitration Rules of the American Arbitration Association" will apply, and that the insured has the option of selecting the TIARs in effect at the time the arbitration is initiated or in effect on the date of the policy. In 2000, the AAA announced it would discontinue the use of the TIARs; however, the ALTA prefers to use the TIARs. In fact, the 2006 ALTA owner's and lender's policies state that "the Title Insurance Arbitration Rules of American Land Title Association" will apply.

The 1987 and 2000 TIARs incorporate the AAA's Commercial Arbitration Rules and Mediation Procedures (CARs). In contrast, the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The current COP (the 2008 COP) went into effect August 1, 2008, and applies to any claim filed on or after that date.

NOTE: The COP has undergone several recent revisions. However, there were few substantive changes between the 2006, 2007, and 2008 versions of the COP. COP Rule 1(C) in each version states the COP Rules in effect at the time the claim is filed will apply, unless the parties agree otherwise. The effective dates of each version are: 2008 COP, claims filed on or after August 1, 2008; 2007 COP, claims filed between August 1, 2007 and July 31, 2008; 2006 COP, claims filed between May 1, 2006 and July 31, 2007; 2005 COP, claims filed between January 1, 2005 and April 30, 2006; and 2003 COP, claims filed between July 1, 2003 and December 31, 2004.

Because the policy form appears to give the claimant a contractual right to arbitrate under the rules in effect at the time the policy was issued, any of these various rules may be in play depending on the policy at issue. A concordance table comparing the content of the CARs; the 2006, 2000, and 1987 versions of the TIARs; and the 2008 COP is provided at the end of this section. A copy of the latest CARs may be found at http://www.adr.org. A copy of the 2008, 2007, 2006, 2005, and 2003 COP Rules may be found at http://www.arb-forum.com.

CAR R-1 states that the CARs are deemed to have been made a part of the parties' arbitration agreement. Likewise, COP Rule 1(A) states that the COP Rules are incorporated in the parties' arbitration agreement.

CAR R-1(a) states that the CARs and any amendments shall apply in the form in effect at the time of the demand for arbitration or when the submission agreement is received by the AAA. COP Rule 1(C) states the COP Rules in effect at the time the claim is filed shall apply, unless the parties agree otherwise.

CAR R-1(a) further provides that the parties may vary the CAR procedures by written agreement. COP Rule 1(D) states that the parties may modify or supplement the COP Rules as permitted by law.

Under CAR R-1(b), if no claim or counterclaim exceeds $75,000 exclusive of interest, arbitration fees, and costs, the Expedited Procedures will apply. Parties may also agree to use the Expedited Procedures in larger cases. The COP Rules also allow parties to request an expedited hearing. See §14.35. Under CAR R-1(c), if the claim or counterclaim is at least $500,000 exclusive of interest, arbitration fees, and costs, then the procedures for Large, Complex Commercial Disputes will apply. See §14.36. COP Rule 2(V) defines a "large claim" as a claim involving $75,000 or more.

2006 Title Insurance Arbitration Rules (2006	*National Arbitration Forum Code of Procedure*	*2000 Title Insurance Arbitration Rules (2000*	*American Arbitration Ass'n Commercial*	*1987 Title Insurance Arbitration Rules (1987*

TIARs)	*(2008 COP Rules)*	*TIARs)*	*Arbitration Rules (CARs)*	*TIARs)*
1. Incorporation of National Arbitration Forum's COP Rules 2. Applicability	1. Arbitration Agreement 48. Interpretation and Application	1. Incorporation of CARs 2. Applicability	R-1. Agreement of Parties	1. Agreement of Parties 54. Amendment of Rules
3. Administration	1. Arbitration Agreement	3. Place of Administration	R-2. AAA and Delegation of Duties	3. Administrator 4. Delegation of Duties 6. Office of Tribunal
		4. National Panel	R-3. National Roster of Arbitrators	5. National Panel of Arbitrators
	6. Service of Claims, Responses, Requests, and Documents 11. Form and Parties 12. Initial Claim 13. Response 14. Counterclaim 15. Cross-Claim 16. Third-Party Claim		R-4. Initiation under Arbitration Provision in Contract	7. Initiation under Arbitration Provision in Policy
			R-5. Initiation under Submission	9. Initiation under Submission
	17. Amendment 19. Joinder, Intervention, Consolidation, and Separation		R-6. Changes of Claim	8. Change of Claim
	20. Authority of Arbitrators		R-7. Jurisdiction	
			R-8. Mediation	
	8. Notices and Conferences		R-9. Administrative Conference	11. Administrative Conference and

				Preliminary Hearing
4. Fixing of Locale	32. Location of In-Person Participatory Hearing	5. Fixing of Locale	R-10. Fixing of Locale	12. Fixing of Locale
	21. Selection of Arbitrators		R-11. Appointment from National Roster	14. Appointment from Panel 16. Notice to Arbitrator of Appointment
	21. Selection of Arbitrators		R-12. Direct Appointment by a Party	
	21. Selection of Arbitrators		R-13. Appointment of Chairperson by Party, Appointed Arbitrators, or Parties	
	21. Selection of Arbitrators		R-14. Nationality of Arbitrator	
	22. Number of Arbitrators	6. Number of Arbitrators	R-15. Number of Arbitrators	15. Number of Arbitrators
	23. Disqualification of Arbitrator 28. Document Hearing 31. Exchange of Information Before Participatory Hearing		R-16. Disclosure	17. Disclosure and Challenge Procedure
	23. Disqualification of Arbitrator		R-17. Disqualification of Arbitrator	13. Qualifications of Arbitrator 17. Disclosure and Challenge Procedure
	24. Communication with Arbitrator		R-18. Communication with Arbitrator	39. Communication with Arbitrator and Serving of Notice
	23. Disqualification of Arbitrator		R-19. Vacancies	18. Vacancies

	8. Notices and Conferences		R-20. Preliminary Hearing	11. Administrative Conference and Preliminary Hearing
	29. Discovery 30. Subpoena for In-Person Participatory Hearing 31. Exchange of Information Before Participatory Hearing		R-21. Exchange of Information	
	25. Selection of Document Hearing 26. Selection of Participatory Hearing 32. Location of In-Person Participatory Hearing		R-22. Date, Time, and Place of Hearing	19. Time and Place
	4. Confidentiality 34. Participatory Hearing Proceedings		R-23. Attendance at Hearing	23. Attendance at Hearings
	3. Representation		R-24. Representation	20. Representation by Counsel
	35. Evidence in Participatory Hearing		R-25. Oaths	25. Oaths
	35. Evidence in Participatory Hearing		R-26. Stenographic Record	21. Stenographic Record
	35. Evidence in Participatory Hearing		R-27. Interpreters	22. Interpreters
	9. Time Periods, Time Extensions, Adjournments, and Stays 33. Participatory Hearing		R-28. Postponements	24. Adjournments

	34. Participatory Hearing Proceedings			
	36. Arbitration Proceedings in Absence of Party		R-29. Arbitration in the Absence of Party or Representative	28. Arbitration in the Absence of Party
	28. Document Hearing 33. Participatory Hearing 34. Participatory Hearing Proceedings		R-30. Conduct of Proceedings	27. Order of Proceedings 36. Waiver of Oral Hearings
6. Evidence	35. Evidence in Participatory Hearing	8. Evidence	R-31. Evidence	30. Evidence
	34. Participatory Hearing Proceedings		R-32. Evidence by Affidavit and Post-Hearing Filing of Documents or Other Evidence	31. Evidence by Affidavit and Post-Hearing Filing of Documents
	35. Evidence in Participatory Hearing		R-33. Inspection or Investigation	32. Inspection or Investigation
	27. Request for Expedited Hearing		R-34. Interim Measures	33. Conservation of Property
	9. Time Periods, Time Extensions, Adjournments, and Stays 34. Participatory Hearing Proceedings		R-35. Closing of Hearing	34. Closing of Hearings
	43. Reopening and Reconsideration		R-36. Reopening of Hearing	35. Reopening of Hearings
			R-37. Waiver of Rules	37. Waiver of Rules
	9. Time Periods, Time Extensions, Adjournments,		R-38. Time Extensions	38. Time Extensions

	and Stays			
	6. Service of Claims, Responses, Requests, and Documents 7. Filing		R-39. Serving of Notice	39. Communication with Arbitrator and Serving of Notice
	37. Awards		R-40. Majority Decision	26. Majority Decision
	37. Awards		R-41. Time of Award	40. Time of Award
	37. Awards		R-42. Form of Award	41. Form of Award
8. Scope of the Award	37. Awards 38. Orders	10. Scope of the Award	R-43. Scope of Award	42. Scope of Award
	40. Voluntary Dismissal		R-44. Award upon Settlement	43. Award upon Settlement
	39. Entry and Service of Awards and Orders		R-45. Delivery of Award to Parties	45. Delivery of Award to Parties
	42. Correction 43. Reopening and Reconsideration		R-46. Modification of Award	
	39. Entry and Service of Award and Orders		R-47. Release of Documents for Judicial Proceedings	46. Release of Documents for Judicial Proceedings
	47. Legal Proceedings		R-48. Applications to Court and Exclusion of Liability	47. Applications to Court and Exclusion of Liability
9. Fee Schedule	44. Fees 45. Waiver of Fees	11. Administrative Fees and Arbitrator's Compensation	R-49. Administrative Fees	48. Administrative Fees 49. Fees when Oral Hearings are Waived
	44. Fees		R-50. Expenses	50 Expenses
9. Fee Schedule	44. Fees	11. Administrative Fees and Arbitrator's Compensation	R-51. Neutral Arbitrator's Compensation	51. Arbitrator's Fee
	44. Fees		R-52. Deposits	52. Deposits

	48. Interpretation and Application of Code		R-53. Interpretation and Application of Rules	53. Interpretation and Application of Rules
	46. Compliance with Rules		R-54 Suspension for Nonpayment	
Expedited Procedures				
	44. Fees		E-1. Limitation of Extensions	
			E-2. Changes of Claim or Counterclaim	
			E-3. Serving of Notices	55. Notice by Telephone
			E-4. Appointment and Qualification of Arbitrator	56. Appointment and Qualifications of Arbitrator
			E-5. Exchange of Exhibits	
	28. Document Hearing		E-6. Proceedings on Documents	
			E-7. Date, Time, and Place of Hearing	57. Time and Place of Hearing
	28. Document Hearing		E-8. Hearing	58. Hearing
			E-9. Time of Award	59. Time of Award
			E-10. Arbitrator Compensation	
Procedures for Large, Complex Commercial Disputes				
			L-1. Administrative Conference	
			L-2. Arbitrators	
			L-3. Preliminary Hearing	
Other				
5. Consolidation of Arbitrations		7. Consolidation of Arbitrations	7. Consolidation of Arbitrations	10. Consolidation of Arbitrations 44. Awards for

				Consolidated Arbitrations
7. Applicable Law		9. Applicable Law		29. Applicable Law
				2. Name of Tribunal

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§14.14 B. Fees and Expenses

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

1987 TIAR 48 states that the initiating party shall pay an administrative fee according to a schedule in effect at the time of the filing, and subject to apportionment by the arbitrator in the final award. CAR R-49 states that the AAA will prescribe an initial filing fee and a case service fee, and fees in effect when the fee or charge is incurred will apply. CAR R-49 further states that the fee shall be advanced by the party making a claim or counterclaim, subject to final apportionment by the arbitrator in the award. 2006 TIAR 9 states that the COP Rules govern the payment of fees, including compensation for arbitrators. The COP Rules prescribe a "filing fee" for filing a claim, a "commencement fee" for commencing arbitration, an "administrative fee" for a document hearing, and a "participatory hearing fee" for a participatory hearing. COP Rule 44 states that the party filing the document or selecting the type of hearing must pay the required fee, but that the prevailing party may recover fees paid.

Although the 2000 TIARs generally incorporate the CARs (in this case CAR R-49), 2000 TIAR 11 states that the insurer shall pay the filing fee associated with the filing of a claim by either the insured or the insurer, and fees for counterclaims shall be paid by the party filing them.

PRACTICE TIP: The 2000 TIARs are alone among the five sets of rules that require the insurer to initially pay the fees for claims filed by the insured. This factor should be considered if the insured has the option of proceeding under these rules rather than one of the other options. In *Pilimai v Farmers Ins. Exch. Co.* (2006) 39 C4th 133, 45 CR3d 760, an insured claiming uninsured motorist benefits under an auto policy made a CCP §998 demand prior to arbitration. The supreme court held that although arbitration in such cases is mandated by statute, it is nonetheless a contractual arbitration subject to the provisions of the California Arbitration Act (CCP §§1280-1294.2), and therefore subject to the cost-shifting provisions of CCP §998. The court affirmed a judgment awarding costs, including expert fees and deposition costs, even though when added to the arbitration award, the total amount exceeded the policy limit. 39 C4th at 151.

NOTE: There is no case on point, but it would appear the same type of arguments could be made in an arbitration regarding a title insurance claim.

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§14.14A 1. Waiver of Fees

1987 TIAR 48 and CAR R-49 further provide that the American Arbitration Association (AAA) may defer or reduce the administrative fee "in the event of extreme hardship on the part of any party." COP Rule 45 permits an "indigent" claimant to request a waiver of claim filing fees, request fees, hearing fees, or security for any arbitration. Further, COP Rule 44(G) states that a "Consumer" (individual) in a "Large Claim" ($75,000 or more) who asserts that arbitration fees prevent the Consumer from effectively vindicating their case in arbitration may, at the time of their initial claim or response and prior to paying any filing fee, file a request that another party or parties pay all or part of the arbitration fees or that the arbitration provision be declared unenforceable, permitting the Consumer to litigate the case instead of arbitrating it.

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§14.14B 2. Witness Fees

1987 TIAR 50 and CAR R-50 state that the expenses of witnesses for either side must be paid by the party producing such witnesses. COP Rule 30 requires the party subpoenaing a nonparty witness to pay the witness a fee of $25 and reasonable travel reimbursement.

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§14.14C 3. Transcript

1987 TIAR 50 and CAR R-50 provide that all other expenses of arbitration, including required traveling and other expenses of the arbitrator, must be borne equally by the parties unless they agree otherwise or unless the arbitrator, in the award, assesses such expenses (or any portion of them) against a specified party or parties.

CAR R-26 provides that the party (or parties) requesting a stenographic record shall pay (or share) the cost of the record. COP Rule 35(F) states that no record of a hearing will be kept unless agreed to by all parties or ordered by the arbitrator, and that the party requesting a record shall arrange and pay the cost.

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§14.14D 4. Arbitrators' Fees

1987 TIAR 51 and CAR R-51 provide that the per diem fee for each arbitrator is set by the arbitrator. Both require that this arrangement for compensation of the arbitrator be made through the American Arbitration Association (AAA) and not directly between the parties and the arbitrator. And both 1987 TIAR 51 and CAR R-51 provide that if there is disagreement over compensation, the AAA has the authority to determine the appropriate fee. COP Rule 44(F) provides that fees for arbitrators selected in accordance with COP Rules will be set according to the National Arbitration Forum's (NAF's) Fee Schedule; arbitrators without NAF qualifications will be paid fees by the responsible party, as determined by the NAF.

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§14.14E 5. Deposits/Advance Fees

1987 TIAR 52 and CAR R-52 permit the American Arbitration Association (AAA) to require a deposit to defray the expense of the arbitration, including the arbitrator's fee, but the Commercial Arbitration Rules (CARs) do not include a fee schedule. COP Rule 44(E) permits the arbitrator or forum to require certain advance fees; however, such advance fees cannot be charged to an individual.

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§14.14F 6. Award of Fees and Costs to Prevailing Party; Attorney Fees

1987 TIAR 42 permits the arbitrator to award fees and expenses to the prevailing party; however, fees and expenses of a three-arbitrator panel may be awarded or apportioned only upon a special finding that the request was justified. CAR R-43(c) states that, in the final award, the arbitrator shall assess the fees, expenses, and compensation and may apportion the fees, expenses, and compensation among the parties in such amounts as the arbitrator determines is appropriate. 1987 TIAR 42 permits the arbitrator to award attorney fees to the prevailing party only if permitted by the law of the state in which the land is located. CAR R-43(d) permits an award of attorney fees to the prevailing party if all parties have requested such an award or it is authorized by law or the arbitration agreement. COP Rules 37(C) and 44.L provide that the prevailing party may recover fees and costs "only as permitted by law." COP Rule 37(C) further provides that a party with a claim for attorney fees may make a separate recovery request, and that fees and costs, if awarded, may be included in the final award or in a separate award.

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Source: Real Property/California Title Insurance Practice/14 Arbitration Procedures/§14.14G 7. Other Fees and Expenses

§14.14G 7. Other Fees and Expenses

1987 TIAR 50 and CAR R-50 provide that all other expenses of arbitration must be borne equally by the parties unless they agree otherwise or unless the arbitrator assesses such expenses (or any portion of them) against a specified party or parties.

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C. Initial Pleadings

1. Commencing Arbitration

§14.15 a. Demand for Arbitration

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

1987 TIAR 7 states that a party may initiate arbitration by giving notice to the other parties of its intention to arbitrate (Demand). 1987 TIAR 9 states that a party may initiate arbitration by filing a written agreement to arbitrate with the AAA (Submission). Similarly, CAR R-4 states that the arbitration process may be initiated either by one party making a demand for arbitration or all parties filing a written submission to arbitrate. See §14.16.

The "Demand," (1987 TIAR 7; CAR R-4) or "Initial Claim" or "Claim" (COP Rule 12), must contain a statement setting forth the nature of the dispute, the names and addresses of the parties, the amount involved (if any), and the remedy sought. Additional copies of the Demand or Claim, copies of the arbitration provision of the contract, and the appropriate administrative fee must be filed. 1987 TIAR 7; CAR R-4; COP Rule 12.

1987 TIAR 7 also requires the Demand to set forth the policy number, the identity and location of the claims office of the insurer (if known), the claim's file number, the name of the individual with whom the claim was discussed, and the address of the AAA office where the Demand is filed. CAR R-4 requires that the Demand include the locale request for the hearing. Further, COP Rule 12 requires a party seeking costs and attorney fees to state the specific amount sought in the Claim or to amend the claim to state the specific amount sought within given time periods. The 2006 COP Rule 12 also requires the claimant to attach any documents that support the Claim (any "available" documents, under the 2007 and 2008 COP Rule 12), and an affidavit asserting that the statements and supporting documents in the Claim are accurate (that the "information" in the Claim is accurate, under the 2007 and 2008 COP Rule 12).

NOTE: The insured may obtain attorney fees and costs incurred for recovery of policy benefits (commonly referred to as *Brandt* fees), but not fees or costs incurred in proving related tort claims against the insurer. *Cassim v Allstate Ins. Co*. (2004) 33 C4th 780, 812, 16 CR3d 374; *Brandt v Superior Court* (1985) 37 C3d 813, 817, 210 CR 211. See also CACI 2350. It is virtually impossible to state the amount of these fees at the initiation of the claim, as most such fees have not yet been incurred. Presumably, the requirement in COP Rule 12(B) that a party state the "specific amount" of fees and costs sought is not meant to apply to *Brandt* fees.

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§14.16 b. Submission by Stipulation

1987 TIAR 9 and CAR R-5 provide that parties to any existing dispute may commence an arbitration by filing two copies of a written agreement to arbitrate with the American Arbitration Association (AAA), called a "Submission." The Submission must be signed by the parties and must contain a statement of the matter in dispute, the amount of money involved (if any), and the remedy sought. CAR R-5 provides that the Submission must also include the names and addresses of all parties, any claims and counterclaims, and the hearing locale requested. CAR R-5 further provides that unless the parties state otherwise in the Submission, all claims and counterclaims are deemed denied by the other party. Both 1987 TIAR 9 and CAR R-5 state that the required filing fee set forth in the fee schedule must be included with the Submission.

The difference between a demand and a submission agreement was an issue in a case arising out of a sports agency and investment agreement. In *Blatt v Farley* (1990) 226 CA3d 621, 276 CR 612, the party opposing arbitration argued for the first time on appeal that the demand for arbitration, which was set forth on a form prepared by the AAA, was a submission agreement; therefore, the arbitrators exceeded their powers by awarding more than double the amount of damages demanded. 226 CA3d at 625. The court disagreed and held that the demand was not a submission agreement; consequently, the award was not limited to the amount or type of damages stated in the demand. 226 CA3d at 627. The court did not, however, address the issue of whether an award "in excess of a demand may be subject to judicial review," because the appellant waived that issue by failing to object at the arbitration. 226 CA3d at 628.

PRACTICE TIP: Whether the arbitration process is initiated by a submission agreement prepared after the dispute arises or a formal demand for arbitration, counsel representing the complaining party should be cautious in estimating the amount of damages and research in advance the nature of the remedies available so that they can be pleaded alternatively. Also, arbitration by mutual consent presents an opportunity for negotiating both procedural and substantive aspects of the case, such as discovery, a ceiling or cap on damages, early exchange of expert information, and a clear statement of which issues are submitted for arbitration and which, if any, are reserved for litigation. For a sample negotiated submission agreement, see California Civil Procedure Before Trial §5.51 (4th ed Cal CEB 2004).

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§14.17 2. Response to Demand

Under 1987 TIAR 7 and CAR R-4(b), the party on whom the Demand is made (responding party) has the option of filing an answering statement. In contrast, COP Rule 13 states that upon service of a Claim, the respondent "shall" serve a response within 30 days from receipt of service, or 14 days from the date of the second notice of arbitration, whichever is later. 1987 TIAR 7 requires any response be filed within 14 days after mailing of a notice of arbitration from the American Arbitration Association (AAA). CAR R-4(b) requires a response to be filed within 15 days after the AAA mails a notice of the Demand to the responding party. Under all three rules, the responding party must send a copy of the answer to the demanding party.

If no answer is filed, or if it is not filed within the prescribed time, 1987 TIAR 7 and CAR R-4(c) provide that the respondent is deemed to deny the claim, and failure to file a response will not delay the arbitration. In contrast, under COP Rule 13 the respondent *must* file a response, which either states the response to the claim or that the respondent has insufficient information to affirm or deny a statement. COP Rule 13(D) provides that failure to deny a statement in a claim may be considered as an admission of that statement. COP Rule 13(A) requires the response to include any defense or counterclaim and their supporting facts, and copies of any documents that support the response. Under COP Rule 13, failure to state objections to arbitration or available replies, defenses, or claims may be barred from later presentation at the hearing.

PRACTICE TIP: In most cases, the answer may be quite brief, but strategic factors may call for more detail. For example, the responding party may wish to include factual background in an attempt to predispose the arbitrator to the argument the party will be presenting or if the party will be making a request for additional discovery. See §14.27. Although the opportunity for an appeal may be slim (see §14.41), a party might wish to include facts in the answer to provide a point of reference for appellate review. Also, a party might wish to include factual detail to frame an issue for collateral estoppel or res judicata if a pending or anticipated claim will not be arbitrated. Finally, specific detail may be essential if the responding party is also presenting a counterclaim. See §14.18.

PRACTICE TIP: The COP Rules differentiate between a "document hearing" in which an issue is submitted to an arbitrator based on documents alone (2006 COP Rule 2(U)(1); 2007 and 2008 Rule 2(T)(1)), and a "participatory hearing" in which testimony and arguments are presented in person, by phone, or online (2006 COP Rule 2(U)(2); 2007 and 2008 Rule 2(T)(2)). COP Rule 26(A)(4) states that in "Common Claims" cases (involving at least one individual "Consumer" with a claim worth less than $75,000), a request for a participatory hearing must be filed no later than 15 days after delivery of a response, or it is waived. Prudent counsel may wish to file a request for a participatory hearing along with the claim or the response.

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§14.18 3. Counterclaim

If the responding party is making a counterclaim, 1987 TIAR 7, CAR R-4(b), and COP Rule 13 each require that the answer contain a statement setting forth the nature of the counterclaim, the amount involved (if any), and the remedy sought. If the answer makes a monetary claim, the responding party must forward the appropriate fee with the answer. COP Rule 14 requires a counterclaim to plainly state the dispute or controversy, the facts and law supporting the relief, the specific amount sought, and the specific value of any nonmonetary relief, interest, costs, and attorney fees sought. Under this rule, the counterclaim must include copies of supporting documents and an affidavit asserting that the information contained therein is accurate. The required filing fee must also be paid.

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§14.19 4. Amendments to Claim

1987 TIAR 8 and CAR R-6 state that if either party desires to make any new or different claim, it must be made in writing and filed with the American Arbitration Association (AAA), with a copy mailed to the other party. The other party may then file an answer. Under 1987 TIAR 8, response time is 14 days after the date of transmission, while under CAR R-6 it is 15 days. 1987 TIAR 8 and CAR R-6 further provide, however, that after the arbitrator is appointed, no new or different claim may be submitted except with the consent of the arbitrator. COP Rule 17 states that a claim or response may be amended:

- At any time by agreement of the parties;
- By request, not later than the scheduling notice deadline or 10 days from the date of the notice of selection of an arbitrator for a document hearing or 30 days before the earliest date set for a participatory hearing, if the amendment will not delay the arbitration and promotes fairness, efficiency, or economy, and if approved by the arbitrator; or
- By request during or immediately following a document or participatory hearing, if the arbitrator finds the amendment conforms to the evidence received.

COP Rule 17 also requires the responsible party to serve all parties and file the amended claim with the National Arbitration Forum (NAF). The other party must file a response within the time remaining for a response to the initial claim or 15 days, whichever is longer. The 2008 version of COP Rule 17 adds that a party may object to an amendment request by filing and delivering a written objection within 10 days of delivery of the request.

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D. Selecting the Arbitrator

§14.20 1. Appointment and Vacancy

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

1987 TIAR 15 states that disputes will be determined by one arbitrator, unless a party requests a panel of three arbitrators. CAR R-15 states that if the contractual provisions do not specify the number of arbitrators, the dispute will be heard and decided by one arbitrator unless the AAA directs the appointment of three arbitrators. COP Rule 22 states that one arbitrator should conduct the hearing and issue an award, unless the parties agree otherwise, in which case that number of arbitrators serves. The NAF designates the chair of the panel, unless the parties agree otherwise.

1987 TIAR 5 states that the AAA will establish and maintain a national panel of title insurance arbitrators. CAR R-3 requires the AAA to establish and maintain a national roster of commercial arbitrators. 1987 TIAR 14 and CAR R-11 govern the appointment of arbitrators from these panels. Under both TIAR 14 and CAR R-11, "immediately" after the filing of the Demand or Submission, the AAA must submit simultaneously to each party an identical list of names of persons chosen from the panel. Each party then has a specified number of days from the date of mailing of that list to cross off any names of persons objected to, number the remaining names to indicate the order of preference, and return the list to the AAA. Under 1987 TIAR 14, the response time is 14 days from the transmittal date of the list, while under CAR R-11 it is 15 days. If the list is not returned within that time, the AAA will deem all persons on the list acceptable. 1987 TIAR 14 and CAR R-11 provide that the AAA will make appointments from the names of persons who have been approved on both lists and in the order of mutual preference designated on the lists. 1987 TIAR 14 and CAR R-13 provide that if the parties fail to agree on any of the persons listed, the acceptable arbitrators are unable to serve, or the appointment cannot be made from the submitted list for any other reason, then the AAA has the power to make the appointment from among other members of the panel without submitting an additional list. In addition, CAR R-11 states that unless the parties agree otherwise, when there are two or more claimants or two or more respondents, the AAA may appoint all the arbitrators.

In contrast, COP Rule 21 provides that the parties may agree upon a single arbitrator or panel of arbitrators, or each party may select an arbitrator and those arbitrators will select another to complete the panel. If the parties cannot agree on one of these methods, COP Rules 21(B)-23 govern the selection process. The COP Rules differentiate appointment procedures for "large claims" by a "consumer claimant"—typically, a homeowner with a claim of $75,000 or more—and all other claims. For Large Claim Hearings, COP Rule 21(B) states that the NAF shall provide a list of candidates equal to the number of parties plus the number of arbitrators required under COP Rule 22. Under COP Rule 22, that number is one, or whatever number of arbitrators the parties had agreed upon to conduct the arbitration. COP Rule 21(B) further provides that each party has 10 days to notify the NAF in writing, striking one name from the list. The 2008 version of the COP adds that a party "may only strike or remove an arbitrator in good faith and not for the purpose of delay or to gain an unfair advantage." See 2008 COP Rule 21(E). A party may request disqualification of a potential arbitrator for conflict of interest or bias under COP Rule 23. For all other claims, COP Rule 21(C) provides that the NAF shall submit one candidate's name to each party; a party may remove one name within 10 days, and may request disqualification of any subsequent candidate for conflict of interest or bias under COP Rule 23.

1987 TIAR 18 and CAR R-19 provide that if any arbitrator resigns, dies, withdraws, refuses to serve, is disqualified, or is unable to perform the duties of an arbitrator, the AAA may declare the "office" of that arbitrator to be vacant. If there is a vacancy on a panel, the remaining arbitrators may continue with the hearing and determine the controversy, unless the parties otherwise agree. In the event that there is no remaining arbitrator, vacancies are filled in accordance with the rules and the arbitration is reheard. CAR R-19 further provides that if a substitute arbitrator is appointed, the

panel will determine in its discretion whether it is necessary to repeat all or part of any prior hearings. COP Rule 23(E) states that if an arbitrator is disqualified or unable to arbitrate before issuance of an award, the NAF will designate a new arbitrator or panel or reschedule the hearing, unless the parties agree otherwise.

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Source: Real Property/California Title Insurance Practice/14 Arbitration Procedures/§14.21 2. Disclosures; Disqualification

§14.21 2. Disclosures; Disqualification

All the rules require a neutral arbitrator to be impartial and independent. 1987 TIAR 17 and CAR R-16 require an arbitrator to disclose to the American Arbitration Association (AAA) any circumstance likely to affect impartiality, including any bias or any financial or personal interest in the result of the arbitration or any past or present relationship with the parties or their representatives. 1987 TIAR 17 states that the disclosure must be made by a person appointed as an arbitrator, while CAR R-16 states that any person appointed or to be appointed must make such disclosure. Under both 1987 TIAR 17 and CAR R-16, the AAA discloses such information to the parties, and when it deems appropriate, to the arbitrator and others. Under 1987 TIAR 17 and CAR R-17, the AAA must determine whether the arbitrator should be disqualified and inform the parties of its decision. The AAA's disqualification decision is conclusive.

Under COP Rule 23(B), an arbitrator must provide the National Arbitration Forum (NAF) with a complete and accurate résumé, and disclose to the NAF "circumstances that create a conflict of interest or cause an Arbitrator to be unfair or biased." COP Rule 23(B) further states that the NAF will disqualify an arbitrator or, alternatively, inform the parties of information disclosed by the arbitrator if the arbitrator is not disqualified. Both the 2007 and 2008 versions of COP Rule 23(C) state that a party must disclose grounds for disqualification of the arbitrator to the arbitrator, the NAF, and all other parties or else those grounds are waived in the arbitration and any other legal proceeding. A party's request to disqualify an arbitrator must be filed within 10 days from the date of the notice of arbitrator selection.

PRACTICE TIP: The 2007 version of Rule 23(C) applied to "circumstances disqualifying an Arbitrator"; the 2008 version applies to "circumstances that may disqualify an Arbitrator." This slight difference in wording indicates that counsel should err on the side of caution and provide notice of facts that may or may not constitute grounds for disqualification.

Under COP Rule 23, grounds for disqualification include, but are not limited to:

- The arbitrator has a personal bias or prejudice concerning a party, or personal knowledge of disputed facts;
- The arbitrator served as an attorney to any party, was associated with an attorney who represented a party during that association, or the arbitrator or an associated attorney is a material witness concerning the matter before the arbitrator;
- The arbitrator, individually or as a fiduciary, or the arbitrator's spouse or minor child residing in the arbitrator's household, has a direct financial interest in a matter before the arbitrator;
- The arbitrator, individually or as a fiduciary, or the arbitrator's spouse or minor child residing in the arbitrator's household, has a direct financial interest in a party;
- The arbitrator, or the arbitrator's spouse or minor child residing in the arbitrator's household, has a significant personal relationship with any party or a representative for a party; or
- The arbitrator or the arbitrator's spouse is a party to the proceeding, or is an officer, director, or trustee of a party, or is acting as a representative in the proceeding.

Statutory disclosure requirements are broader and more explicit than those in the 1987 TIARs or the CARs, and quite similar to those in the COP Rules. For instance, under CCP §§1281.6 and 1297.121(a), all neutral arbitrators must disclose within 15 days of appointment any information that might cause their impartiality to be questioned on the basis of "personal bias or prejudice concerning a party, or personal knowledge of disputed evidentiary facts concerning the proceeding."

In addition, under the more detailed provisions of CCP §1281.9, an arbitrator must disclose all facts that are grounds for challenging a judge under CCP §170.1, and any party has the right, on demand made before the arbitration concludes, to disqualify an arbitrator who:

- Has personal knowledge of evidentiary facts disputed in the proceeding;
- Served as a lawyer in the proceeding or gave advice to any party in the proceeding on any matter related to the proceeding;

- Has a financial interest in the subject matter of the proceeding or in a party to the proceeding;
- Is a party or an officer, director, or trustee of a party to the proceeding;
- Has a spouse, or a relative within the third degree of relationship to the arbitrator or spouse, who is a party or an officer, director, or trustee of a party to the proceeding;
- Has a spouse, former spouse, child, sibling, or parent (or the arbitrator's spouse has such a relative) who is a lawyer, the spouse of a lawyer, or associated in the private practice of law with a lawyer in the proceeding;
- Has for any reason (1) a belief that his or her own recusal would further the interests of justice, (2) a substantial doubt that he or she could not be impartial, or (3) knowledge that a person aware of the facts might reasonably doubt that he or she would be able to be impartial;
- Is biased or prejudiced towards a lawyer in the proceeding;
- Is unable to perceive the evidence or conduct the proceedings properly because of permanent or temporary physical disability; or
- Has a current arrangement concerning prospective employment or other compensated service as a dispute resolution neutral or is participating in, or within the last two years has participated in, discussions regarding such employment or service and either (1) the arrangement is, or the discussion was, with a party to the proceeding, or (2) the matter before the arbitrator includes issues relating to the enforcement of an agreement to submit a dispute to alternative dispute resolution or the appointment or use of a dispute resolution neutral.

Under CCP §1281.9(a), as amended, anyone proposed for nomination or appointed by the court to serve as a neutral arbitrator must disclose to all parties in writing within ten calendar days after service of notice of the proposed nomination or appointment all of the following:

> (1) The names of the parties to all prior or pending noncollective bargaining cases in which the proposed neutral arbitrator served or is serving as a party arbitrator for any party to the arbitration proceeding or for a lawyer for a party and the results of each case arbitrated to conclusion, including the date of the arbitration award, identification of the prevailing party, the names of the parties' attorneys and the amount of monetary damages awarded, if any. In order to preserve confidentiality, it shall be sufficient to give the name of any party who is not a party to the pending arbitration as "claimant" or "respondent" if the party is an individual and not a business or corporate entity.
> (2) The names of the parties to all prior or pending noncollective bargaining cases involving any party to the arbitration or lawyer for a party for which the proposed neutral arbitrator served or is serving as a neutral arbitrator, and the results of each case arbitrated to conclusion, including the date of the arbitration award, identification of the prevailing party, the names of the parties' attorneys and the amount of monetary damages awarded, if any. In order to preserve confidentiality, it shall be sufficient to give the name of any party who is not a party to the pending arbitration as "claimant" or "respondent" if the party is an individual and not a business or corporate entity.
> (3) Any attorney-client relationship the proposed neutral arbitrator has or had with any party or lawyer for a party to the arbitration proceeding.
> (4) Any professional or significant personal relationship the proposed neutral arbitrator or his or her spouse or minor child living in the household has or has had with any party to the arbitration proceeding or lawyer for a party.

Code of Civil Procedure §1281.9(b) states that if any proposed nominee or appointee fails to make these disclosures, any party may serve a notice of disqualification within 15 calendar days after the proposed nominee or appointee fails to comply. Code of Civil Procedure §1281.9(c) states that a party may disqualify a proposed nominee or appointee "on the basis of the disclosure statement" within 15 calendar days after service of the disclosure statement. This subdivision states that the proposed nominee or appointee *shall* be disqualified, indicating that such disclosure is mandatory if a party serves a notice of disqualification. Further, CCP §1281.9(b) does not provide any limitations or guidelines on the parties' right to serve a notice of disqualification.

NOTE: The disclosures listed in CCP §1281.9(a) must be made in any contractual arbitration proceeding, when the arbitrator is "subject only to the disclosure requirements of law." Although there is no authority stating specifically that CCP §1281.9(a) applies to a title policy arbitration under 1987 TIARs, the AAA Rules, or the COP Rules, it appears to apply to all arbitrations by the intent expressed in the legislative history. See Senate Judiciary Committee Analysis of AB 1093 (July 9, 1997).

If an arbitrator does not make the required disclosures in a timely manner and proceeds to hear the matter, the

award may be vacated by any party suffering substantial prejudice by the failure to disclose. See §14.42.

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§14.22 E. Prohibition on Communication with Arbitrator

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

1987 TIAR 39, CAR R-18, and COP Rule 24 prohibit communication between the parties and the arbitrator other than at a hearing. Any other oral or written communications from the parties to the arbitrator must be directed to the AAA or the NAF for transmittal to the arbitrator.

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§14.23 F. Joining Additional Parties

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

One potential disadvantage of arbitration is the limited ability to join additional parties. See §14.12. Because arbitration under a title policy is based on a contractual agreement to arbitrate, nonsignatories generally cannot be forced to participate in the arbitration. *Unimart v Superior Court* (1969) 1 CA3d 1039, 1045, 82 CR 249. Neither can a nonsignatory compel arbitration against a party who entered into an agreement with other parties to arbitrate disputes arising out of the same transactions in which the nonsignatory party was involved. *Arista Films, Inc. v Gilford Secs.* (1996) 43 CA4th 495, 51 CR2d 35. For example, COP Rule 16 permits a respondent to serve a third-party claim if the third party is (1) a signatory to the arbitration agreement, (2) a nonparty that was not served by the claimant, and (3) responsible for the award demanded by the claimant.

Depending on the nature of the defect or loss, it may be advantageous to the insured or the insurer to join an additional party or parties. For example, if the title insurer did not handle the escrow and the defect is based on a failure to vest title in the insured because of the escrow agent's alleged error, the insured or the insurer may wish to join the escrow agent as an additional party to the arbitration.

Under California authorities applicable to contractual arbitration in general, the ability to join nonsignatories appears to be quite limited. California courts have, however, enforced an arbitration agreement against principals or agents of a party to the arbitration agreement under general agency principles. In *Keller Constr. Co. v Kashani* (1990) 220 CA3d 222, 227, 269 CR 259, an arbitration provision in a limited partnership's contract with a third party was enforced against the limited partnership's general partner.

In addition, third party beneficiaries may be treated as parties to the contract. Thus, the third party beneficiaries may be bound by an arbitration provision in the contract. *Van Tassel v Superior Court* (1974) 12 C3d 624, 627, 116 CR 505, overruled on other grounds in *Bouton v USAA Cas. Ins. Co.* (2008) 43 C4th 1190, 1200, 78 CR3d 519. An argument can be made that additional insureds under a title policy (including heirs, distributees, devisees, survivors, personal representatives, next of kin, corporate or fiduciary successors, or successor-owners of an insured indebtedness) may be bound by the arbitration provision as third party beneficiaries.

PRACTICE TIP: In the context of title insurance, unless the nonsignatory is an agent or principal of the insured or insurer or a third party beneficiary under the policy, a court is unlikely to compel the nonsignatory to participate in the arbitration. Thus, the insured and insurer may face a two-front battle: one involving arbitration under the policy and the other involving litigation against a nonsignatory. In such a case, if the nonsignatory cannot be persuaded to voluntarily submit the claims to arbitration, it may be advantageous to the other parties to stipulate that they litigate their claims and join their claims against the nonsignatory. From the insured's perspective, this step eliminates the costly undertaking of two proceedings: one involving arbitration against the insurer and the other involving litigation against a nonsignatory. From the insurer's perspective, if liability of the nonsignatory can be proved, and that liability would eliminate or reduce the insurer's liability under the policy, the insurer may wish to litigate one action rather than face an arbitration with the insured followed by a subrogation suit against a nonsignatory. See also §14.12.

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G. Consolidation of Arbitrations

§14.24 1. Grounds

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

Even though the ability to join nonsignatories and unrelated claims in an arbitration proceeding under a title policy is quite limited (see §14.23), under the 1987 TIARs there is more than one method to consolidate a title insurance arbitration with another arbitration. Under 1987 TIAR 10, two or more such actions may be consolidated if the following conditions exist:

- All parties to each arbitration agree to arbitrate their disputes under the 1987 TIARs; or
- An arbitrator appointed to consider consolidation orders consolidation; and
- Either the policies on which the arbitrations are based are linked, or the parties or issues of the arbitrations are related, so that consolidation results in a more economic or efficient disposal of all claims; and
- There are common issues of fact to be determined in each of the arbitrations, proof of which will or could be substantially the same.
- No party is substantially prejudiced.

1987 TIAR 10 further provides that neither incomplete identity of fact issues nor varying policy terms or measures of damage is a reason to refuse consolidation, unless the differences are of a number and complexity that make determination of the liabilities unwieldy or difficult.

The CARs do not contain any express provisions regarding consolidation when the parties do not stipulate. However, the "Standard Arbitration Clause" of the "Introduction" section of the CARs indicates arbitration of "existing disputes" may be accomplished via an agreement and a Submission to arbitrate, and suggests the following language:

> **We, the undersigned parties, hereby agree to submit to arbitration administered by the American Arbitration Association under its Commercial Arbitration Rules the following controversy: (describe briefly). We further agree that the above controversy be submitted to (one) (three) arbitrator(s). We further agree that we will faithfully observe this agreement and the rules, that we will abide by and perform any award rendered by the arbitrator(s), and that a judgment of any court having jurisdiction may be entered on the award.**

The 2006 ALTA owner's and lender's policies state that except as provided in the COP Rules, "there shall be no joinder or consolidation with claims or controversies of other persons."

COP Rule 19(C) provides for consolidation of arbitrations involving the same parties and a common issue of fact or law arising from the same or related transaction or occurrence, if consolidation would promote fairness, efficiency, or economy. However, under COP Rule 19(A), the arbitrator cannot issue an order or award binding any nonparty individual, unless that individual or entity agrees to be bound.

If one of the parties does not agree to arbitrate the dispute under the rules, a consolidation order may be obtained under CCP §1281.3, which allows a court to consolidate arbitrations even when the respective agreements name different tribunals for the hearing and contain inconsistent provisions. See *Garden Grove Community Church v Pittsburgh-Des Moines Steel Co.* (1983) 140 CA3d 251, 191 CR 15; *Atlas Plastering, Inc. v Superior Court* (1977) 72 CA3d 63, 140 CR 59.

In an unusual case, *Gordon v G.R.O.U.P., Inc.* (1996) 49 CA4th 998, 1004, 56 CR2d 914, the court consolidated a binding contractual arbitration with a judicial nonbinding arbitration for hearing before a single arbitrator. In *Gordon*, passengers injured in a van struck by an uninsured stolen car filed a lawsuit against the owners and drivers of both

vehicles. These claims were suitable for judicial arbitration. Because the driver of the car was never identified, the passengers also pursued uninsured motorist claims against the van owner, which were subject to binding contractual arbitration. After hearing all claims, the arbitrator found the car driver to be 100-percent liable and resolved the uninsured motorist claims in favor of the passengers. The van owner requested a trial de novo, and the passengers moved to confirm the award. The trial court confirmed the award and struck the request for the trial de novo, and the appellate court affirmed.

NOTE: If the arbitrator in *Gordon* had made a finding of liability against the car owner or the van driver, or partial liability against the van owner, presumably any of them could have requested a trial de novo. This would have presented the danger of inconsistent results. Thus, consolidation of a binding title insurance arbitration and a nonbinding judicial arbitration may achieve consolidation in the short term, but may still present the danger of multiple proceedings and inconsistent results.

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§14.25 2. Consolidation Procedure Under 1987 TIARs

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

Any party wishing to consolidate one arbitration with another under the 1987 TIARs must notify in writing all interested parties and the AAA. If a party does not object to consolidation within 14 days after receipt of the notice, it is deemed to agree to consolidation. 1987 TIAR 10.

If any party timely objects to consolidation, 1987 TIAR 10 requires the AAA to appoint one arbitrator to hear the consolidation request. The AAA must fix a time for the filing of written submissions by the parties dealing solely with the issue of consolidation. The arbitrator may order an oral hearing "in exceptional cases." 1987 TIAR 10 further provides that the arbitrator's ruling regarding consolidation is final.

If two or more arbitrations are consolidated under 1987 TIAR 10, the arbitrator who heard the issue of consolidation decides whether a new arbitrator will hear the consolidated arbitrations. If so, a new arbitrator or panel is selected and appointed under 1987 TIAR 14. Any of the arbitrators previously appointed for the separate arbitrations may adjudicate the consolidated arbitration.

1987 TIAR 10 also provides that no consolidation may be ordered if a request is first received later than 7 days before the first date on which hearings in any of the arbitrations are scheduled to commence.

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§14.26 H. Conferences and Preliminary Hearings

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

1987 TIAR 11 and CAR R-9 provide that, at the request of any party or on the AAA's own initiative, the AAA may conduct an administrative conference, in person or by telephone, with the parties or their representatives, or both. 1987 TIAR 11 states this conference may arrange for an exchange of information and stipulations to uncontested facts. Under CAR R-9, the conference may address such issues as arbitrator selection, potential mediation of the dispute, potential exchange of information, a timetable for hearings, and any other administrative matters.

Both 1987 TIAR 11 and CAR R-20 provide for a preliminary hearing between the arbitrator and the parties. Such a hearing may be requested by the parties or may be scheduled at the discretion of the AAA administrator. 1987 TIAR 11 states that the hearing may address production of relevant documents and other evidence, identification of witnesses, scheduling of further hearings, and consideration of any other matters that will expedite the proceedings. CAR R-20 states simply that the parties should discuss "the future conduct of the case, including clarification of the issues and claims, a schedule for the hearings and any other preliminary matters." COP Rule 8 states that the NAF or any party or arbitrator may request a conference to discuss procedural matters; the 2007 and 2008 COP Rule 8(C) adds that the Forum may schedule a "preliminary hearing." These hearings present an opportunity for counsel to negotiate procedural aspects of the hearing and gain additional information about the contested issues before the arbitration hearing.

PRACTICE TIP: Because an arbitrator is not required to state findings of fact or reasons for the decision in the arbitration award (see §14.38), attorneys facing arbitration under a title policy should consider the potential impact of collateral estoppel and res judicata. If an attorney desires to take advantage of these principles, he or she should take affirmative steps to facilitate the application of these principles by a subsequent fact-finder. For example, the attorney may request a preliminary hearing with the AAA, during which the parties through counsel may stipulate to facts, agree that any stipulated facts be written and incorporated in the arbitration award, and stipulate that in the award the arbitrator make specific findings of fact on disputed issues and set forth the reasons and legal basis for the award. Even if the other parties refuse to agree, any attorney may make a written request that the arbitrator include in the award findings of fact, legal conclusions, and the reasons for the decision.

CAR R-21 states that the arbitrator may direct the production of documents and other information and the identification of witnesses to be called, and is authorized to resolve disputes concerning this exchange of information.

COP Rule 31 states that before all participatory hearings, each party must deliver to all other parties and to the NAF:

- A list of all witnesses expected to testify and a summary of their testimony;
- A list and description of all exhibits to be introduced;
- A copy of all documents and a detailed description of any property to be introduced at the hearing; and
- An affidavit establishing the authenticity of any document proposed to be introduced at the hearing.

This information must be delivered at least 10 days prior to the hearing. And, under COP Rule 31, the arbitrator may exclude witnesses, testimony, or documents not included in this exchange of information.

1987 TIAR 11 and CAR R-8 further provide that the AAA may arrange a mediation conference, but only with the consent of all parties. Both rules state that the mediator may not be one of the arbitrators appointed in the arbitration.

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Source: Real Property/California Title Insurance Practice/14 Arbitration Procedures/§14.27 I. Discovery

§14.27 I. Discovery

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

Parties in title insurance arbitration generally do not enjoy the same self-executing provisions under the Civil Discovery Act (CCP §§2016.010-2036.050) that are available to parties in court litigation (see chap 13). Most of the discovery in arbitration takes the form of the exchange of documents and witness lists. More extensive discovery requires the permission of the arbitrator.

Under 1987 TIAR 30, CAR R-20, and COP Rule 30, any party or the arbitrator may schedule a preliminary hearing to arrange for the production of relevant documents and other evidence and to identify witnesses to be called (see §14.26). This preliminary hearing may by held by telephone.

1987 TIAR 30 states that the arbitrator may order discovery of evidence upon the request of a party and upon a determination that the request is "reasonable and necessary for the party to prepare and present its case."

While there is no express provision in the CARs for discovery in smaller cases, CAR R-21 provides that, at the request of any party or at the discretion of the arbitrator, the arbitrator may direct the parties to produce documents and other information and identify witnesses to be called. At least 5 business days prior to the hearing, the parties must provide copies of all materials they intend to submit. Under CAR R-31, the arbitrator is authorized to (independently or upon the request of any party) subpoena witnesses or documents. The CAR procedures for Large, Complex Commercial Cases, CAR L-1—L-4, do contain discovery provisions. CAR L-3 requires a preliminary hearing in which one of the issues is "the extent to which discovery shall be conducted." CAR L-4 permits the parties to conduct such discovery as agreed to by all parties, and provides that if the parties do not agree, the arbitrator has discretion to establish the extent of discovery to be permitted. Further, under CAR L-4, the arbitrator may "order depositions of, or the propounding of interrogatories to, such persons who may possess information determined by the arbitrator(s) to be necessary to determination of the matter." This apparently authorizes a party to propound an "interrogatory" to a nonparty witness; although the CARs provide no further explanation, presumably this would be similar to a deposition on written questions. Parties must exchange all exhibits they intend to submit 10 business days prior to the hearing, unless the arbitrator determines otherwise.

COP Rule 29 states that parties are to cooperate in the exchange of discovery documents and information. If the parties are unable to resolve a discovery dispute, COP Rule 29 provides that a party may seek disclosure of documents, sworn answers to no more than 25 written questions, and one or more depositions. A party may seek other discovery, including requests for admissions and for physical or mental examinations. However, any discovery request must satisfy the following requirements:

- The information sought is relevant to a claim or response, and reliable and informative to the arbitrator;
- The cost is commensurate with the amount of the claim; and
- The production of information sought is reasonable and not unduly burdensome and expensive.

COP Rule 29 requires a party seeking discovery to deliver to all other parties a notice identifying the documents to be produced, questions to be answered, deponent's names, and the length and scope of depositions no later than 30 days before the date of a participatory hearing or not later than 10 days from the date of notice of election of an arbitrator in the case of a document hearing. The party receiving a notice of a deposition must provide a written reply within 5 days either agreeing to the deposition, or objecting and stating an explanation of the objections. The party receiving a notice for other discovery must, within 20 days, provide a copy of the documents requested or a statement permitting an examination of the original documents or property at a convenient time and place, sworn answers to questions or a written agreement to provide other requested discovery, or a written objection explaining why all or some of the documents, property, or other discovery has not been provided.

Under COP Rule 29, if a party objects to discovery, the requesting party may request a discovery order under COP Rule 18, providing the NAF and all other parties with a copy of the Rule 18 request, the written objections, and a written statement of reasons why the requesting party needs the discovery. The request must be filed no later than the scheduling notice deadline or 10 days after receiving an objection. The arbitrator must "promptly" determine whether sufficient reason exists for the discovery and issue an order. The arbitrator may also impose on the nonprevailing party sanctions, costs, and fees related to seeking or resisting discovery, including attorney and administrative fees. Further, under COP Rule 29, the arbitrator may draw an unfavorable, adverse inference or presumption from the failure of a party to provide discovery.

The 1987 TIARs, the CARs, and the standard coverage policies contain no further authorization or limitation on the type, sequence, or order of discovery that may be used by the parties. Accordingly, the augmented discovery procedures outlined in CCP §1283.05 are unavailable in title insurance arbitration proceedings under those rules. See CCP §1283.1(b).

Under CCP §1282.2(a)(2)(A), parties in cases involving claims of more than $50,000 may demand from the other parties a list of witnesses (including expert witnesses) to be called and documents to be introduced at the hearing. Failure to list a witness or document is not fatal to the case; the testimony of the unlisted witness or the undesignated exhibit may be admitted into evidence if good cause for the omission is shown. CCP §1282.2(a)(2)(E).

NOTE: In *Fitz v NCR Corp.* (2004) 118 CA4th 702, 13 CR3d 88, an arbitration provision in an employment contract limited the parties to only two depositions and required that all exhibits and a list of potential witnesses be exchanged at least 2 weeks prior to the hearing. No other discovery was allowed unless the arbitrator found a "compelling need" to allow it. The court held that the discovery limitations were substantively unconscionable because they unfairly restricted the employee's ability to obtain information and documents that were already in the possession of the employer. The authors are not aware of similar challenges to the TIARs, CARs, or COP Rules.

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Source: Real Property/California Title Insurance Practice/14 Arbitration Procedures/§14.28 J. Summary Judgment and Involuntary Dismissal

§14.28 J. Summary Judgment and Involuntary Dismissal

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

COP Rule 41 permits an arbitrator (at the request of the NAF or a party on the arbitrator's initiative) to dismiss a claim or response that is:

- Not supported by evidence;
- Not supported by existing law;
- Frivolous;
- Presented or maintained for an improper purpose, such as to harass, cause unnecessary delay, or needlessly increase the cost of arbitration; or
- Made by a party that has violated any provision of the COP Rules or any order or notice from an arbitrator or the NAF.

Under the 2007 and 2008 versions of COP Rule 41, a claim or response may be dismissed if brought by a party who has been declared to be a vexatious litigant by a court or arbitrator.

Further, under COP Rule 41 in the 2007 and 2008 versions of the COP, a claim or response may be dismissed by the arbitrator, the NAF, or at the request of a party for one or more of the following reasons:

- A party failed to proceed with an arbitration or claim;
- A party failed to pay fees as provided in the Fee Schedule;
- More than 120 days (90 days in the 2007 version) elapsed between the filing date of the claim and the date the NAF received a response or proof of service of the initial claim;
- More than 60 days elapsed after a hearing was postponed or an arbitration case was placed on inactive status.

The 2008 version adds one additional ground for involuntary dismissal:

- More than 12 months elapsed since a case was stayed under Rule 9F1 and no notification was received from the claimant to extend the stay.

A motion for summary judgment in a contractual arbitration proceeding has been expressly approved for the resolution of cases in which the disputed issues are legal rather than factual. See *Schlessinger v Rosenfeld, Meyer & Susman* (1995) 40 CA4th 1096, 1105, 47 CR2d 650. The court suggested that summary adjudication may also be appropriate when sufficient discovery has been conducted and the facts are undisputed. Such a procedure would "provide an efficient means of evaluating the same evidence that would otherwise be presented at a more time-consuming trial." 40 CA4th at 1107. The court cautioned that the propriety of such procedures in any particular arbitration depends on a number of factors, including the nature of the claims and defenses, the arbitration terms set forth in the agreement, the applicable rules, the availability of discovery, and the opportunity to conduct the discovery necessary to make or oppose the motion for summary judgment. 40 CA4th at 1112. See Subbotin, *Summary Judgment in an Arbitration Setting*, 18 CEB Civ Litigation Rep 10 (Feb. 1996).

PRACTICE TIP: The *Schlessinger* decision was based in part on former CAR R-10, which allowed an arbitrator to consider "other matters that will expedite the arbitration proceedings." See current CAR L-4, which authorizes the arbitrator(s) to "take such steps as they may deem necessary or desirable to avoid delay and to achieve a just, speedy and cost-effective resolution"; CAR R-30, which authorizes the arbitrator(s) to vary the procedure regarding the conduct of the proceedings; and CAR R-32, which authorizes the arbitrator(s) to receive evidence by declaration. There is no language in the current CARs like former CAR R-10. Under CAR R-30, however, the

arbitrator may vary the hearing procedures or order of proof if "the parties are treated equally and each party has the right to be heard and is given a fair opportunity to present its case." This language mirrors the due process formula in the *Schlessinger* opinion. Thus, it appears that with an opportunity to conduct adequate discovery beforehand, the hearing procedures in the CARs may be varied to allow for a motion for summary judgment or summary adjudication to resolve all or some of the issues in the case. The discretionary language in CAR R-30 means that the arbitrator may refuse to consider a summary judgment motion.

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V. ARBITRATION HEARING

§14.29 A. Time and Place

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

Under 1987 TIAR 12, the parties may mutually agree on the locale for the arbitration, or one party may make a request for a specific locale. Parties have 14 days in which to object to a locale request. Under 1987 TIAR 19, the arbitrator fixes the time and place for each hearing, within the locale selected by the parties under 1987 TIAR 12; however, the parties and arbitrator may agree on another site. 1987 TIAR 19 further states that the AAA will mail notice of the hearing to each party at least 14 days in advance, unless the parties agree to waive or modify this provision.

Under CAR R-10, the parties may agree on the date, time, and locale for the arbitration hearing. If they do not agree, CAR R-10 states that if any party requests a specific locale, and the other party files no objection within 15 days after the AAA sends the notice of the request, the locale will be the one requested. If an objection is filed, the arbitrator will determine the locale. Under CAR R-22, the arbitrator sets the time and date for each hearing, and the AAA must send a notice of hearing to the parties at least 10 days before the hearing date unless the parties agree otherwise.

Under COP Rule 32, an "in-person participatory hearing" must be held in the location that the arbitration agreement designates or where the parties otherwise agree, or in the absence of an agreement, at a reasonably convenient location within the United States where the respondent to the initial claim resides or does business.

Under AAA rules, in practice, when the arbitrator disclosure and selection process is completed, the AAA typically sends a 3-month schedule to all parties to the arbitration and requests that each party block out those days on which the party is not available to coordinate the calendars of all participants, including the arbitration panel. This practice usually results in the parties having notice of the arbitration hearing 30-90 days in advance. The same process may be simplified when the arbitration hearing is arranged by mutual consent during a preliminary hearing. See §14.26. In any event, CAR R-38 permits the AAA or the arbitrator for good cause to extend any time period established in the CARs except for the time for making the award after hearing.

COP Rule 9 permits the NAF to extend time periods upon request of a party, provided it is filed and served 5 days before the applicable time period ends or no later than a deadline set by a scheduling notice, whichever is earlier. A request submitted after the applicable time period has ended will not be considered absent "extraordinary circumstances."

See also CCP §1282.2(b) (arbitrator may postpone hearing for good cause to a time no later than the date fixed by agreement for making the award).

PRACTICE TIP: Code of Civil Procedure §1282.2(a)(2) mandates a 60-day minimum hearing notice for contractual arbitration proceedings in which the amount in controversy exceeds $50,000 on the timely request of any party. To be effective, the request must be made before the arbitrator serves notice of the initial hearing date. Under the present practices of the AAA, such a request appears to be timely if it is made at a preliminary hearing or when responding to the AAA solicitation for calendar availability of the parties and their counsel.

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§14.30 B. Transcript of Hearing

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

There is no requirement that the arbitration proceedings be recorded. COP Rule 35 states that no record will be kept unless agreed by all parties or ordered by the arbitrator. If a party desires a stenographic record, the party desiring a record must make arrangements directly with a court reporting service and must notify the other parties of those arrangements at least 3 days before the hearing. 1987 TIAR 21, CAR R-26, and COP Rule 35 all require the party or parties requesting the record to pay the costs of the recording.

PRACTICE TIP: Counsel may request a record of the arbitration hearing if (1) a possibility exists for future application of the principles of res judicata or collateral estoppel, *e.g.*, a nonarbitrable claim between the same parties arising out of the same transaction; (2) counsel anticipates the filing of a motion by either party to vacate or modify the award; or (3) counsel expects an appeal by either party on the limited grounds provided by statute. See §§14.40-14.43.

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§14.31 C. Subpoenas

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

The arbitrator or other person authorized by law may issue subpoenas for witnesses or documents. 1987 TIAR 30; CAR R-31; COP Rule 30; CCP §1282.6. In addition, the arbitrator has the discretion to issue subpoenas and subpoenas duces tecum independently of a party. 1987 TIAR 30; CAR R-31; COP Rule 30; CCP §1282.6(a). Under CCP §1282.6(c), subpoenas must be served and enforced in accordance with CCP §§1985-1997.

PRACTICE TIP: The required subpoena forms should be ordered as early as possible. Waiting until receipt of the notice of the arbitration hearing is risky. Also, to reduce the time and expense of preparing and serving subpoenas on party witnesses, both counsel should endeavor to stipulate to the application of CCP §1987(b)-(c) to allow for service on opposing counsel of notices to produce in lieu of subpoenas or subpoenas duces tecum directed to party witnesses.

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§14.32 D. Evidence

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

1987 TIAR 30 and CAR R-31 provide that each party may offer evidence that is relevant and material to the dispute and "shall produce such evidence as the arbitrator may deem necessary to an understanding and determination of the dispute." CAR R-31 further states that all evidence must be taken in the presence of all parties and all arbitrators, except when any of the parties is absent, is in default, or has waived the right to be present. The arbitrator determines the relevance and materiality of evidence presented; conformity to legal rules of evidence is not necessary. 1987 TIAR 30; CAR R-31; COP Rule 35; CCP §1282.2(d). An arbitrator, however, exceeds statutory powers by relying on extrinsic evidence to reform or interpret the terms of a contract that contains an integration clause. *Bonshire v Thompson* (1997) 52 CA4th 803, 60 CR2d 716.

Under 1987 TIAR 31 and CAR R-32, the arbitrators may receive and consider evidence of witnesses by affidavit. The arbitrator is required, however, to give this evidence only the weight to which the arbitrator deems it is entitled after consideration of any objections made to its admissibility. Under CAR R-25, the testimony of witnesses need not be given under oath unless requested by a party to the arbitration or required by law. CCP §1282.2(d). In contrast, COP Rule 35 requires the arbitrator to administer an oath or affirmation before a witness testifies.

1987 TIAR 31, CAR R-32, and COP Rule 34 also provide for the submission of documents after the hearing. 1987 TIAR 31 and CAR R-32 state that such documents must be filed with the AAA for transmission to the arbitrator, and all parties must be afforded the opportunity to examine them. COP Rule 34 provides that such documents must be received by the arbitrator, the NAF, and all other parties no later than 30 days after the final hearing.

Under 1987 TIAR 32, CAR R-33, and COP Rule 35, the arbitrator may make an inspection or investigation if it is deemed necessary. Any party may be present at the inspection or investigation. 1987 TIAR 32 and CAR R-33 further state the arbitrator will set the time, and the AAA will notify the parties of the inspection. Any party may be present at the inspection or investigation, and if all parties are not present, the arbitrator must make a verbal or written report to the parties and afford them an opportunity to comment.

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§14.33 E. Order of Proceedings

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

Although not specified in the 1987 TIARs or the CARs, the arbitrator may permit the parties or counsel to give opening statements similar to those that might be given in a court trial. In contrast, COP Rule 33 specifically authorizes opening statements.

Although the arbitrator has discretion under 1987 TIAR 27, CAR R-30, and COP Rule 34 to vary the procedure, usually, as in litigation, the complaining party presents its claim, proofs, and witnesses first. The responding party then presents its defense, proofs, and witnesses. 1987 TIAR 27 and CAR R-30 require the arbitrator to treat all parties with equality and to afford each party the right to be heard and a fair opportunity to present its case. COP Rule 35 similarly states that each party must be given a full and equal opportunity to present relevant and reliable evidence and oral and written arguments in support of their positions.

PRACTICE TIP: Even though the arbitrator must allow each party the opportunity to present all relevant evidence, TIAR 27, CAR R-30, and COP Rule 34 allow the arbitrator to alter the order of proof, which is rare in court trials. Some arbitrators make an enormous effort at the beginning of a hearing or testimony to reduce the overall hearing time by having the parties stipulate to undisputed or foundational facts. This discretionary power may trap unwary counsel, who may be forced to examine unprepared witnesses and cross-examine opposing witnesses at an earlier time and at a faster pace than is usually required in a court trial.

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§14.34 F. Close of Hearings; Supplemental Briefs and Evidence

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

Under 1987 TIAR 34 and CAR R-35, the arbitration hearing is closed when all parties state that they have no further proof to offer or witnesses to be heard, or when supplemental briefs are filed or supplemental documents are received, whichever is later. COP Rule 33 provides that a participatory hearing is closed when either the arbitrator announces the hearing closed, or more than 20 days have elapsed from the final session. The arbitrator may allow briefs and documents to be filed after the hearing. 1987 TIAR 31, 34; CAR R-32; COP Rule 34. If the arbitrator considers additional information presented after the hearing, such as briefs and documents filed under the rules, the arbitrator must disclose the information to all parties to the arbitration and give them an opportunity to respond. CCP §1282.2(g).

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Source: Real Property/California Title Insurance Practice/14 Arbitration Procedures/§14.35 G. Expedited Procedures

§14.35 G. Expedited Procedures

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

Expedited procedures are available under 1987 TIARs, CARs, and COP Rules. The 1987 TIARs and the CARs make these expedited procedures available for claims under a specified dollar value. The dollar limit, exclusive of arbitration fees and costs, is $50,000 under 1987 TIAR 7, and $75,000 under CAR R-1. Those expedited procedures are set forth in 1987 TIAR 55-59 and CAR E-1-E-10. Under COP Rule 27, any party may request an expedited hearing to obtain emergency relief, without regard to the dollar value of the claim.

Under 1987 TIAR 55 and CAR E-3, the parties must accept notices from the AAA by telephone, which are later confirmed in writing. Further, failure to confirm such telephonic notice in writing does not invalidate such notice.

Under 1987 TIAR 56 and CAR E-4, the AAA submits simultaneously to each party an identical list of five members of the panel list from which one arbitrator is appointed. Each party has the right to strike two names from the list for any reason. Under CAR E-4, the list must be returned to the AAA within 7 days; under 1987 TIAR 56, the time limit is 10 days. If, "for any reason," appointment of the arbitrator cannot be made from the list, 1987 TIAR 56 and CAR E-4 state that the AAA has the authority to appoint an arbitrator without submitting any additional lists of names to the parties. The sole arbitrator is subject to disqualification under 1987 TIAR 17 or CAR R-17. Under 1987 TIAR 56 and CAR E-4, the parties are notified of the name of the arbitrator by telephone. Under CAR E-4, the parties must raise any objections to that arbitrator within 7 days; under 1987 TIAR 56, the time limit is 10 days.

Under 1987 TIAR 57 and CAR E-7, the arbitrator selects the date, time, and place of the hearing. CAR E-7 states that the AAA will notify the parties "in advance" of the hearing. 1987 TIAR 57 specifies that the AAA will notify the parties 10 days in advance of the hearing.

1987 TIAR 58 and CAR E-8 state that, generally, "the hearing shall be completed within one day." For good cause shown, however, an additional hearing may be scheduled within 7 business days under CAR E-8 and within 5 days under 1987 TIAR 58. CAR E-5 requires the parties to exchange copies of all exhibits they intend to submit at the hearing at least 2 business days before the hearing.

1987 TIAR 59 states that unless otherwise agreed by the parties, the award must be rendered no later than 5 business days from the closing of the hearing. CAR E-9 sets that deadline at 14 days from the closing date of the hearing, or, if oral hearings have been waived, from the date of the AAA's transmittal of the final statements and proofs to the arbitrator.

CAR E-6 states that when no party's claim exceeds $10,000, exclusive of interest and arbitration costs, and in other cases in which the parties agree, the dispute shall be resolved by submission of documents, unless a party requests an oral hearing or the arbitrator determines an oral hearing is necessary.

Under CAR E-1, the AAA or the arbitrator may grant a party no more than one 7-day extension to respond to the demand for arbitration or counterclaim.

CAR E-2 states that a claim or counterclaim may be increased in amount, or a new or different claim or counterclaim added, on agreement of the other party or the consent of the arbitrator; however, after the arbitrator is appointed, no new or different claim may be submitted without the arbitrator's consent. Further, if the increased claim or counterclaim exceeds $75,000, the case will be administered under the "regular procedures" unless all parties and the arbitrator agree the case may continue under the expedited procedures.

COP Rule 27 allows any party to seek an expedited hearing to obtain an interim order or emergency relief. COP Rule 2(U) defines an "interim order" as "[a]ny order providing temporary or preliminary relief pending a final Award." "Emergency relief" is not defined. However, under COP Rule 27(D), a temporary restraining order or preliminary injunction may be sought, provided all the parties are businesses and no party is a "Consumer" (defined in COP Rule 2(L) as an individual with certain personal claims). The requesting party must serve a notice of the expedited hearing

on all parties at least 48 hours before the time set for the hearing. If the request for an expedited hearing is granted by the arbitrator, the hearing must be scheduled "as soon as possible."

Finally, COP Rule 28 permits a "Document Hearing," in which the arbitrator decides the issue based solely on documents submitted and without testimony or oral argument. While not denominated as an expedited hearing, in most cases, a document hearing should be concluded more quickly than a "Participatory Hearing."

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Source: Real Property/California Title Insurance Practice/14 Arbitration Procedures/§14.35A H. Procedures for Large, Complex Commercial Disputes

§14.35A H. Procedures for Large, Complex Commercial Disputes

The CARs include special procedures for Large, Complex Commercial Disputes. Under CAR R-1(c), these special procedures apply to all cases in which the claim or counterclaim of any party is at least $500,000, exclusive of claimed interest, arbitration fees, and costs. Further, under CAR R-1(c), the parties may stipulate to use these special procedures in other situations. The key features of the CAR Procedures for Large, Complex Commercial Disputes are:

- An administrative conference;
- Provisions for a panel of three arbitrators selected from the Large, Complex Commercial Case Panel;
- A preliminary hearing to address additional procedural issues and the exchange of additional information; and
- Additional provisions regarding management of the proceedings, including provisions for additional discovery.

CAR L-1 requires the AAA to conduct an administrative conference, unless the parties agree otherwise. This conference is to be conducted by conference call and take place within 14 days after commencement of the arbitration. If the parties cannot agree on a time, the AAA may discuss the issues with the parties individually. The administrative conference should include, but not be limited to, the following topics:

- Obtain additional information about the nature and magnitude of the dispute and the anticipated length of hearing and scheduling;
- Discuss the views of the parties about the technical and other qualifications of the arbitrators;
- Obtain conflicts statements from the parties; and
- Consider, with the parties, whether mediation or other nonadjudicative methods of dispute resolution might be appropriate.

Under CAR L-2, the parties may agree to have the case heard and determined by either a single arbitrator or a panel of three arbitrators. If the parties do not agree, and a claim or counterclaim involves at least $1,000,000, then three arbitrators shall be appointed; if the parties do not agree and each claim or counterclaim is less than $1,000,000, then a single arbitrator shall be appointed. The AAA shall appoint the arbitrator(s) as agreed by the parties. If the parties do not agree, the AAA shall appoint arbitrators from the Large, Complex Commercial Panel, in the same manner as provided under the CARs. Absent agreement of the parties, no arbitrator shall have served as a mediator in the case.

Under CAR L-3, the arbitrators must hold a preliminary hearing. Unless the parties agree otherwise, this preliminary hearing must be conducted by conference call. The matters to be addressed at the preliminary hearing shall include, but not be limited to:

- Service of a detailed statement of claims, damages, and defenses, a statement of the issues asserted by each party and positions with respect thereto, and any legal authorities the parties may wish to bring to the attention of the arbitrator(s);
- Stipulations to uncontested facts;
- The extent to which discovery will be conducted;
- Exchange and premarking of any documents that each party believes may be offered at the hearing;
- Identification and availability of witnesses, including experts, and such matters with respect to witnesses, including their biographies and expected testimony, as may be appropriate;
- Whether, and the extent to which, any sworn statements and/or depositions may be introduced;
- The extent to which hearings will proceed on consecutive days;
- Whether a stenographic or other official record of the proceedings will be maintained;
- The possibility of utilizing mediation or other nonadjudicative methods of dispute resolution; and
- The procedure for issuing subpoenas.

CAR L-4 addresses additional procedural issues, including the need for additional discovery, and vests the arbitrators with authority to take such steps as they deem necessary to avoid delay and achieve a just, speedy, and

cost-effective resolution of large, complex commercial cases. For example, CAR L-4 provides that:

- Parties shall cooperate in the exchange of documents, exhibits, and information within such party's control if the arbitrators consider such production to be consistent with the goal of achieving a just, speedy, and cost-effective resolution of a large, complex commercial case.
- The parties may conduct such discovery as may be agreed to by all the parties, provided, however, that the arbitrators may place such limitations on the conduct of such discovery as the arbitrators shall deem appropriate. If the parties cannot agree on production of documents and other information, the arbitrators, consistent with the expedited nature of arbitration, may establish the extent of the discovery.
- At the discretion of the arbitrators, on good cause shown and consistent with the expedited nature of arbitration, the arbitrators may order depositions of, or the propounding of interrogatories to, such persons who may possess information that the arbitrators deem necessary to determination of the matter.
- The parties shall exchange copies of all exhibits they intend to submit at the hearing ten business days before the hearing unless the arbitrators determine otherwise.
- The exchange of information under CAR L-4, as agreed by the parties and/or directed by the arbitrators, shall be included within the Scheduling and Procedure Order.
- The arbitrator is authorized to resolve any disputes concerning the exchange of information.
- Generally, hearings will be scheduled on consecutive days or in blocks of consecutive days to maximize efficiency and minimize costs.

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§14.36 I. Right of Representation

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

Code of Civil Procedure §1282.4 provides that any party to an arbitration has the right to be represented by an attorney at any proceeding or hearing in contractual arbitration. See also 1987 TIAR 20; CAR R-24; COP Rule 3. Although this right may be waived, the waiver may be revoked. If a party revokes the waiver, however, "the other party is entitled to a reasonable continuance for the purpose of procuring an attorney." CCP §1282.4(a).

The statute does not provide any guidelines on the proper time to revoke a waiver of the right to be represented by counsel; however, prudence dictates that it be done at the very least before the hearing commences, because this right is only statutory and not constitutionally based. TIAR 20 and CAR R-24 require a party intending to be represented by counsel to notify the other party and the AAA of the name and address of counsel at least 3 days before the proceeding at which counsel is first expected to appear.

Code of Civil Procedure §1282.4(b) currently permits a party to an arbitration in California to be represented by an attorney who is not licensed in California if the attorney is licensed in another state, complies with the notice requirements of CCP §1282.4, and has the approval of the arbitrator, arbitrators, or arbitral forum. The attorney must serve a certificate containing specified information on the arbitrators, the other parties and their counsel, and the State Bar. This provision permitting representation by out-of-state attorneys is set to expire on January 1, 2007.

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VI. ARBITRATION AWARD

§14.37 A. Time for Award

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

Under 1987 TIAR 40 and CAR R-41, the award must be made promptly. Unless the parties agree otherwise or specified by law, the arbitration award must be made no later than 30 days after the date of closing of the hearings. The 30-day time period begins to run, in the absence of other agreement by the parties, on the close of the hearings, which (under 1987 TIAR 34 and CAR R-35) may be the date on which supplemental briefs are filed or supplemental documents are received. Under CAR R-41, if there was no oral hearing, the award must be made no later than 30 days after the date of transmitting the final statements and proofs to the arbitrator.

The parties may extend the time for the making of the award either before or after the initial time expires, but the arbitrator and the AAA may not. 1987 TIAR 38; CAR R-38. A party waives any objection that the award is untimely unless that party gives the arbitrator written notice of the objection before the award is served. CCP §1283.8.

In contrast to the more specific provisions of the 1987 TIARs and the CARs, COP Rule 37(E) states only that the arbitrator "shall endeavor to render an Award within twenty (20) days after the date of the close of the Hearing."

Under the CAR-expedited procedures in which hearings of 1 day or less apply, the award must be rendered within 14 business days after the close of the hearing, unless the parties otherwise agree. CAR E-9. See §14.35.

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Source: Real Property/California Title Insurance Practice/14 Arbitration Procedures/§14.38 B. Content and Scope of Award

§14.38 B. Content and Scope of Award

NOTE: The 1987 Title Insurance Arbitration Rules (TIARs) and the 2000 TIARs incorporate by reference Commercial Arbitration Rules (CARs) of the American Arbitration Association (AAA), while the 2006 TIARs incorporate the Code of Procedure (COP Rules) of the National Arbitration Forum (NAF). The AAA has discontinued use of the TIARs in favor of the CARs; however, the American Land Title Insurance Association (ALTA) continues to use the TIARs. See §14.13 for a concordance table and additional discussion of these sets of rules.

The arbitration award must be written and signed by the arbitrator or, if there is a panel, a majority of the arbitrators. 1987 TIAR 41; CAR R-42; COP Rule 37. The 1987 TIARs are silent on whether the arbitrator must make any findings of fact or conclusions of law. CAR R-42 states that the arbitrator need not render a reasoned award unless the parties request such an award, or the arbitrator deems it appropriate. The rule further states that such a request must be made prior to the appointment of the arbitrator.

2006 COP Rule 37 states that the award is a summary award unless a prior written agreement of the parties requires reasons, findings of fact, or conclusions of law, or a party files a written notice seeking reasons, findings, or conclusions. Under 2007 and 2008 COP Rule 37, even if a prior written agreement requires reasons, at least one party must file a written notice requesting reasons, findings, or conclusions. Under either version, the request must be made within 10 days of the date of notice of selection of arbitrator.

California statutory provisions require the arbitrator to include "a determination of all the questions submitted to the arbitrators," the decision of which is necessary to resolve the dispute. CCP §1283.4. Arbitrators are not required, however, to render findings of fact or give reasons for their conclusions. *Pacific Veg. Oil Corp. v C.S.T., Ltd.* (1946) 29 C2d 228, 232, 174 P2d 441.

The award may grant relief to the prevailing party beyond that which was originally contemplated by the parties to the contract. See *Advanced Micro Devices, Inc. v Intel Corp.* (1994) 9 C4th 362, 36 CR2d 581, discussed in §14.49.

The chief limitation in the scope of the award under 1987 TIAR 42 and COP Rule 37 is that the award may not exceed the amount of any claim or counterclaim, as disclosed when filed or on later amendment. Otherwise, the arbitrator's discretion in fashioning an award is quite broad. The arbitrator may grant any remedy or relief that the arbitrator deems just and equitable and within the scope of the agreement of the parties. Further, the arbitrator may assess arbitration fees, expenses, and compensation and apportion them among the parties. 1987 TIAR 42; CAR R-43; COP Rule 37.

Similarly, in *Advanced Micro Devices, Inc. v Intel Corp., supra*, the California Supreme Court held that

> arbitrators, unless expressly restricted by the agreement of the parties, enjoy the authority to fashion relief they consider just and fair under the circumstances existing at the time of the arbitration, so long as the remedy may be rationally derived from the contract and the breach.

None of the standard coverage policies currently being issued (see chap 6) have an attorney fees clause for the prevailing party in actions arising out of the policy; therefore, attorney fees may be awarded in title insurance arbitrations in only extraordinary circumstances. See, *e.g.,* §§11.6, 11.9, 11.34, 11.122, 13.39.

CAR R-43 provides that if all parties have requested an award of attorney fees, or if it is authorized by law, the arbitrator has the discretion to award those fees. COP Rule 37 similarly states that a party with a claim for attorney fees or costs may make a request for them, and such fees and costs may be included in the final award or in a separate award. These provisions are consistent with Condition 13 of the CLTA policy and the 1992 ALTA lender's policy, Condition 14 of the 1992 ALTA owner's policy, and Condition 8 of the 1987 Residential policy. Notably, Condition 14 of the 2006 ALTA owner's policy, Condition 13 of the 2006 ALTA lender's policy, and Condition 11 of the 1988 Homeowners policy make no mention of attorney fees. See §14.2. Although California does not have a general statute authorizing an award of attorney fees to the prevailing party in a civil action generally, in insurance bad-faith cases an insured may recover, as an element of tort damages, attorney fees incurred in obtaining the enforcement of insurer obligations under a policy of insurance. *Brandt v Superior Court* (1985) 37 C3d 813, 817, 210 CR 211. Only fees

incurred to prove entitlement to policy benefits are recoverable, however; fees allocable to prove that the insurer's conduct amounted to bad faith are not recoverable. 37 C3d at 819; *Cassim v Allstate Ins. Co*. (2004) 33 C4th 780, 812, 16 CR3d 374. See §§11.34, 13.39.

The arbitrator may apportion fees, expenses, and compensation of the arbitrator among the parties. 1987 TIAR 42; CAR R-43; COP Rule 37.

If the responding party in the arbitration served a CCP §998 offer on the complaining party, and the complaining party rejected it and did not obtain an award more favorable than the offer, then the arbitrator must award costs incurred from the time of the offer to the responding party and against the complaining party, who cannot recover his or her postoffer costs. The arbitrator has discretion to award costs of expert witnesses' services reasonably incurred in either, or both, preparation for the trial or arbitration, or during the trial or arbitration, to the responding party and against the complaining party, in addition to a mandatory award of costs to the responding party. CCP §998(c)(1).

If the complaining party, however, served a CCP §998 offer on the responding party, and the responding party rejected it and did not obtain an award more favorable than the offer, then the arbitrator has the discretion to award costs of expert witnesses' services reasonably incurred in either, or both, preparation for the trial or arbitration, or during the trial or arbitration, to the complaining party and against the responding party, in addition to a mandatory award of costs to the complaining party. CCP §998(d).

For further discussion of the scope and finality of an arbitration award, see California Civil Procedure Before Trial §§5.32, 5.34 (4th ed Cal CEB 2004).

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§14.39 C. Delivery of Award

1987 TIAR 45 and CAR R-45 authorize the American Arbitration Association (AAA) to (1) mail a copy of the award to the party at its last known address or to its attorney; (2) personally serve the award; or (3) file the award in any manner that may be prescribed by law. CAR R-45 also permits electronic service of the award. COP Rule 39 permits the National Arbitration Forum (NAF) to deliver the award to any address on record for the party or their attorney by mail, private service, fax, or electronic service. See also CCP §1283.6.

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§14.40 D. Enforcement of Award

1987 TIAR 47 and CAR R-48(c) provide that the parties are deemed to have consented that judgment on the arbitration award may be entered in any federal or state court having jurisdiction. COP Rule 39(A) states that the award "shall be entered in the state, country, or other jurisdiction" provided for the arbitration hearing.

Under CCP §1287.6, an arbitration award that has not been confirmed or vacated has the same force and effect as a contract in writing between the parties to the arbitration. An enforceable judgment is obtained by a petition to confirm the award. Under CCP §1286, the court must enter a judgment confirming the award unless a petition to correct or vacate the award has been filed. The prevailing party is entitled to a judgment, and the losing party cannot prevent the entry of a judgment even by paying the amount of the arbitration award. *Pacific Law Group: USA v Gibson* (1992) 6 CA4th 577, 580, 7 CR2d 878.

The procedures for obtaining the judgment confirming the award are slightly different under California law as opposed to federal law. Under California law, a petition to confirm the award cannot be filed until at least ten days after service of the signed copy of the award on the petitioner. CCP §1288.4. Further, the petition must be filed and served no later than four years after the date of service of a signed copy of the award on the petitioner. CCP §1288. Under federal law, a party *may* seek confirmation of the award within one year after the award is made. 9 USC §9. The authorities are split, however, on whether this provision establishes a one-year statute of limitations on filing a motion to confirm an arbitration award under the FAA. See *Photopaint Technols., LLC v Smartlens Corp.* (2d Cir 2003) 335 F3d 152, 156 ("may" refers to discretion to seek confirmation of award, but if sought, petition must be filed within one year); *Sverdrup Corp. v WHC Constructors, Inc.* (4th Cir 1993) 989 F2d 148, 151 ("may" is permissive only, and petition may be filed beyond the one-year period); *Val-U Constr. Co. of S.D. v Rosebud Sioux Tribe* (8th Cir 1998) 146 F3d 573, 581 (same holding).

Under both California and federal law, a judgment confirming the arbitration award has the same force as any other civil judgment and may be enforced like any other judgment. CCP §1287.4; 9 USC §15. The judgment confirming the award is appealable. CCP §1294(d); 9 USC §16(a)(3).

There is no requirement that the arbitration award be confirmed through a judgment. An unconfirmed arbitration award "has the same force and effect as a contract in writing between the parties." CCP §1287.6. Even an unconfirmed arbitration award is entitled to collateral estoppel and res judicata effect. *Trollope v Jeffries* (1976) 55 CA3d 816, 823, 128 CR 115. Thus, in later litigation between the parties, any issues actually determined and necessary to the determination in the arbitration proceeding are entitled to collateral estoppel effect. *State Farm Mut. Auto. Ins. Co. v Superior Court* (1989) 211 CA3d 5, 14, 259 CR 50. Under res judicata principles, an arbitration award bars relitigation of the matters that were heard or could have been heard in the arbitration proceeding. *Thibodeau v Crum* (1992) 4 CA4th 749, 755, 6 CR2d 27.

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§14.41 E. Challenging the Award

A party who desires to challenge an arbitration award must file a petition either to vacate or to correct the award, or challenge the award in response to a petition to confirm, correct, or vacate the award. CCP §§1285, 1285.2; *Louise Gardens of Encino Homeowners Ass'n v Truck Ins. Exch.* (2000) 82 CA4th 648, 658, 98 CR2d 378. The procedures are set forth in CCP §§1285.4-1286.8, 1290-1294.2. Unless there are grounds to vacate or correct the award, the award is not subject to judicial review based on claimed errors of law. *Moncharsh v Heily & Blase* (1992) 3 C4th 1, 33, 10 CR2d 183. See also *Cummings v Future Nissan* (2005) 128 CA4th 321, 331, 27 CR3d 10. The sufficiency of the evidence is not reviewable. *Case v Alperson* (1960) 181 CA2d 757, 761, 5 CR 635. An arbitrator has broad equitable power to fashion a remedy that may even exceed the original terms of the disputed contract. See §§14.38, 14.49.

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§14.42 1. Grounds to Vacate Award

Grounds for vacating an arbitration award are set forth in CCP §1286.2. That statute provides that an arbitration award *shall* be vacated if the court determines any of the following:

- The award was procured by corruption, fraud or other undue means;
- There was corruption in any of the arbitrators;
- The rights of the party were substantially prejudiced by misconduct of a neutral arbitrator (see, *e.g.*, *Ceriale v Amco Ins. Co.* (1996) 48 CA4th 1629, 56 CR2d 353 (if arbitrator does not make required disclosures in a timely manner, award may be vacated));
- The arbitrators exceeded their powers, and the award cannot be corrected without affecting the merits of the decision on the controversy submitted (see, *e.g.*, *Bonshire v Thompson* (1997) 52 CA4th 803, 60 CR2d 716);
- The rights of the party were substantially prejudiced by the arbitrators' refusal to postpone the hearing on a showing of sufficient cause or hear evidence material to the controversy, or by other conduct of the arbitrators contrary to statute; or
- An arbitrator making the award was subject to disqualification on grounds specified in CCP §1281.9, but failed on receipt of timely demand to disqualify himself or herself. See §14.21.

Although a detailed discussion of the myriad grounds to vacate an arbitration award is beyond the scope of this book, it is clear that an arbitration award cannot be vacated on the ground that the arbitrators made an error in fact or law or assigned erroneous reasons for their decision. If that were grounds to vacate an award, every losing party could obtain judicial review simply by claiming the arbitrators erred and thus exceeded their powers. *Moncharsh v Heily & Blase* (1992) 3 C4th 1, 28, 10 CR2d 183. See also *Allstate Ins. Co. v Superior Court* (2006) 142 CA4th 356, 362, 48 CR3d 266.

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§14.43 2. Grounds for Correcting Award

The grounds for correcting an arbitration award are set forth in CCP §1286.6. That statute provides that the court *shall* correct the award and confirm it as corrected if the court determines that:

- There was an evident miscalculation of figures or an evident mistake in the description of any person, thing, or property referred to in the award;
- The arbitrators exceeded their powers, but the award may be corrected without affecting the merits of the decision on the controversy submitted; or
- The award is imperfect in a matter of form not affecting the merits of the controversy.

In *Allstate Ins. Co. v Superior Court* (2006) 142 CA4th 356, 48 CR3d 266, the arbitration agreement specified that the arbitrator would not issue a written opinion other than to indicate which party prevailed and how much the defendant should pay to the plaintiff. Nevertheless, the arbitrator issued a five-page ruling, which spelled out the reasoning in detail. The court treated the statement of reasoning as surplusage and held that the award could be corrected by redacting the reasons for the decision. 142 CA4th at 362. In *Moncharsh v Heily & Blase* (1992) 3 C4th 1, 13, 10 CR2d 183, however, the supreme court held that an arbitration award cannot be judicially corrected substantively even when a noncomputational error appears on the face of the award and a manifest injustice will occur as a result of the uncorrected award.

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§14.44 VII. COMPARISON OF ARBITRATION AND LITIGATION

An attempt to compare all litigation procedures with their arbitration counterparts is beyond the scope of this chapter. Selected litigation procedures, including discovery, and considerations peculiar to title insurance actions are more fully discussed in chap 13. In five key areas, however, arbitration and litigation can be distinctly different. See §§14.45-14.49.

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§14.45 A. Permissive Joinder of Parties and Claims

Although the ability to join additional parties and claims in an arbitration is extremely limited (see §14.23), the permissive joinder rules applicable in litigation are much more lenient (see §§13.8-13.11). See also California Civil Procedure Before Trial, chap 14 (4th ed Cal CEB 2004). Depending on the nature of the particular claim, the ability to join additional parties may be crucial. This distinction may require a "race to the courthouse."

PRACTICE TIP: If it is essential that a party bring a claim against a nonsignatory to the title policy who cannot be compelled to participate in the arbitration, counsel should consider filing a lawsuit against that third party as well as the adverse party to the title dispute, *i.e.,* either the insured or the insurer. As the court exercises its equitable powers in deciding whether to compel arbitration, the court has discretion not to compel arbitration or may stay arbitration if it determines that competing claims by third parties pose a danger of conflicting results. CCP §1281.2(c); *Henry v Alcove Inv.* (1991) 233 CA3d 94, 101, 284 CR 255; *Green v Mt. Diablo Hosp. Dist.* (1989) 207 CA3d 63, 74, 254 CR 689; *C.V. Starr & Co. v Boston Reins. Corp.* (1987) 190 CA3d 1637, 1640, 236 CR 167. See §14.12.

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§14.46 B. Discovery

Although the usual rules of discovery apply in litigation, discovery is quite limited in title policy arbitration. See §§13.13, 14.27. CAR R-21 provides that the arbitrator may direct the production of documents and other information. Under CAR L-4, the arbitrator may order discovery for good cause. Thus, unlike discovery in litigation, discovery in title policy arbitration is not self-executing; a party must request permission for discovery and convince the arbitrator that it is both reasonable and necessary.

PRACTICE TIP: Anecdotal reports indicate that, especially in bad-faith claims, title insurers attempt to restrict discovery in arbitration to the greatest extent possible. It is obviously in neither party's best interest to engage in unnecessary document exchanges or depositions, but the fact that discovery in title policy arbitration is not self-executing and may be limited by the arbitrator is a key disadvantage to arbitration.

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§14.47 C. Appeals

Unless the arbitration agreement clearly provides otherwise, an arbitration award cannot be challenged for insufficient evidence or an error in law even if the error is apparent on the face of the award and causes substantial injustice. *Moncharsh v Heily & Blase* (1992) 3 C4th 1, 33, 10 CR2d 183; *Case v Alperson* (1960) 181 CA2d 757, 761, 5 CR 635. See §§14.41-14.43. See also *Christensen v Smith* (2009) 171 CA4th 931, 90 CR3d 57. However, parties may take themselves out of the general rule that the merits of an award are not subject to judicial review if they clearly agree that legal errors are an excess of arbitral authority that is reviewable by the courts. *Cable Connection, Inc. v DIRECTV, Inc.* (2008) 44 C4th 1334, 1361, 82 CR3d 229, disapproving *Crowell v Downey Community Hosp. Found.* (2002) 95 CA4th 730, 735, 115 CR2d 810; *Christensen v Smith* (2009) 171 CA4th 931, 936, 90 CR3d 57; *Oakland-Alameda County Coliseum Auth. v CC Partners* (2002) 101 CA4th 635, 645, 124 CR2d 363. The provision found by the California Supreme Court in *Cable Connection* to be "clear" stated as follows: "The arbitrators shall not have the power to commit errors of law or legal reasoning, and the award may be vacated or corrected on appeal to a court of competent jurisdiction for any such error." 44 C4th at 1361 n20.

Because arbitration proceedings are not recorded unless a party requests and pays for a transcript, obtaining a sufficient record for an appeal requires careful pre-planning. See §§14.26, 14.30. The ability to obtain appellate review of a judgment following litigation is a key advantage of litigating title policy disputes.

PRACTICE TIP: If an insured seeks punitive damages or an unreasonable amount of compensatory damages, the insurer's immediate reaction may be to assert its right to contractual arbitration to avoid an excessive verdict. In view of the discretionary power being vested in arbitrators (see §14.49), the insurer may instead prefer to stay in litigation and preserve its appeal rights. The same may be true for the insurer if (1) the insured is pursuing a novel theory of recovery or (2) a strict construction of the policy will result in a judgment against the insured, whose case would otherwise arouse sympathy.

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§14.48 D. Right to Jury Trial

In litigation, the proper interpretation of a contract of insurance (as well as the determination of the scope of coverage afforded by that insurance contract) is more often than not a question of law to be decided by the court. See, *e.g.*, *State Farm Fire & Cas. Co. v Eddy* (1990) 218 CA3d 958, 965 267 CR 379; *Brodkin v State Farm Fire & Cas. Co.* (1989) 217 CA3d 210, 216, 265 CR 710; *Suarez v Life Ins. Co.* (1988) 206 CA3d 1396, 1402, 254 CR 377.

Evidence Code §310 provides, in pertinent part:

> All questions of law (including but not limited to questions concerning the construction of statutes and other writings…) are to be decided by the court.

Further, if the insurance contract terms are clear and unambiguous, the insured's subjective expectations regarding the extent of coverage afforded by the policy are not relevant. *Helfand v National Union Fire Ins. Co.* (1992) 10 CA4th 869, 884, 13 CR2d 295; *Dalton v Metropolitan Prop. & Liab. Ins. Co.* (1982) 136 CA3d 1037, 1041, 186 CR 685; *Pepper Indus. v Home Ins. Co.* (1977) 67 CA3d 1012, 1018, 134 CR 904.

It is also clearly established, however, that in litigation by an insurance company against its insured seeking a declaration that no coverage exists, the insured has the right to a jury trial because the declaratory relief action has been substituted for an action at law for breach of contract. See *Manneck v Lawyers Title Ins. Corp.* (1994) 28 CA4th 1294, 1299, 33 CR2d 771; *Inter-Insurance Exch. v Savior* (1975) 51 CA3d 691, 694, 124 CR 239. See §13.36. Likewise, in litigation involving claims of breach of the insurance contract or bad faith, both the insured and the insurer have the right to a jury trial. CCP §592. For causes of actions for fraud and attorney malpractice arising out of fee disputes between an insurer and independent counsel, there is a right to a jury trial. *Fireman's Fund Ins. Cos. v Younesi* (1996) 48 CA4th 451, 459, 55 CR2d 671.

Obviously, in title policy arbitrations, there is no jury. All issues are decided by the arbitrator or, in a panel of three arbitrators, by a majority of the arbitrators. The absence of a jury and thus the lack of a potential for a runaway verdict may be seen as an advantage by the insurer and as a disadvantage by the insured.

PRACTICE TIP: In some claims, there are no or few disputed facts, or the issues may turn on the proper interpretation of the policy or valuation of the loss. Particularly in cases in which bad faith is not alleged and it appears that the court will decide most or all of the issues, stipulating to a court trial of all issues should be considered. The parties may even wish to stipulate to a referee if they can agree on a qualified and neutral referee. Through a court trial (with or without a referee), the insurer can avoid the potential of a runaway jury and both parties may seek to join additional necessary parties, utilize the usual self-executing discovery process, obtain a full record of the proceedings and have full appellate rights. Further, if the parties can agree on a referee, they may be able to avoid a crowded court docket. In summary, although arbitration and litigation are mutually exclusive, nothing prevents creative counsel from fashioning a process that affords the maximum advantages and protections suitable to the specific facts of the case.

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§14.49 E. Available Remedies

Unless the parties' agreement provides otherwise, an arbitrator enjoys the discretion to fashion any permanent relief that is just and fair under the circumstances of the case at the time of the arbitration as long as the remedy bears a rational relationship to the contract and the breach. *Advanced Micro Devices, Inc. v Intel Corp.* (1994) 9 C4th 362, 383, 36 CR2d 581. See §14.38. An arbitrator has no power, however, to order or grant provisional remedies pending the arbitration process. See §14.4.

The relief given in an arbitration award may go beyond the performance that would have been rendered by the defendant had it fully performed without breaching the contract. 9 C4th at 391. This standard allows an arbitrator to award a remedy that is unavailable to a trial court or a jury. 9 C4th at 384.

EXAMPLE: In *Advanced Micro Devices*, the arbitrator designed remedies for, among other things, breach of the covenant of good faith and fair dealing by substantially altering the licensing of intellectual property rights set forth in the contract between the plaintiff and the defendant. In particular, the plaintiff was awarded (1) "a permanent, nonexclusive and royalty-free license" to the defendant's intellectual property embodied in a microchip and (2) a two-year extension of related patent and copyright licenses. 9 C4th at 370. The defendant had contended that the contracts provided for payment of royalties and only a temporary exchange license of the intellectual property rights in the microchip. 9 C4th at 387 n15.

Therefore, the arbitrator's ability to exceed the bounds of legal remedies is a distinct disadvantage of the arbitration process, which may be compounded by the fact that some arbitrators are not attorneys.

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15

Additional Title Company Services

Alice L. Akawie

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Source: Real Property/California Title Insurance Practice/15 Additional Title Company Services/§15.1 I. INTRODUCTION

§15.1 I. INTRODUCTION

Title companies provide many services in addition to insuring title, including:

- Preparing standard form documents (see §§15.2-15.3);
- Acting as escrow agent for the closing (customary in northern California and becoming more common in southern California) (see §§15.5-15.8, 10.3);
- Recording documents as an accommodation (usually for good customers only) (see §15.9);
- Acting as trustee under a deed of trust (see §§15.10-15.17);
- Acting as a trust company through means of a wholly owned subsidiary (see §15.18); and
- Providing quick information (*e.g.*, the name of an owner of a parcel of property or a copy of a recorded document) through its customer service department (see §15.19).

Many industry watchers believe that the basic products and services of the title industry will change as sophisticated consumers seek access to title data but elect self-insurance or other products to eliminate risk. Recognizing this, many title companies are already expanding the range of services offered customers and venturing into other real property areas. Examples of such services include:

- Credit data reporting;
- Agent referrals;
- Flood certification; and
- Appraisals.

This chapter focuses on the more traditional title-related services now provided by title companies.

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II. PREPARATION OF STANDARD FORM DOCUMENTS

§15.2 A. Common Examples

Title companies frequently prepare standard form documents for parties to transactions who are not represented by counsel. Such documents are limited to the title company's own preprinted forms. Generally, the title company only fills in the blanks on these forms. Common examples are:

- Deeds;
- Deeds of trust;
- Assignments of deed of trust;
- Promissory notes;
- Installment land sale contracts;
- Subordination agreements (see §15.3);
- Requests for reconveyance;
- Deeds of reconveyance (see §15.11);
- Substitutions of trustee (see §15.15); and
- Requests for notice under CC §2924b.

PRACTICE TIP: Attorneys should carefully consider the adequacy of such forms in all but the simplest transactions. Because forms prepared for a buyer or borrower are usually less onerous than those prepared for a seller or lender, the attorney for a buyer or borrower may choose to let the title company prepare standard form documents for his or her client.

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Source: Real Property/California Title Insurance Practice/15 Additional Title Company Services/§15.3 B. Subordination Agreements

§15.3 B. Subordination Agreements

Among the more common documents prepared by title companies are subordination agreements that effect changes in priorities in sales and lending transactions. Leases are commonly subordinated to new financing, often by an attornment and nondisturbance agreement (see §5.15; Retail Leasing: Drafting and Negotiating the Lease, chap 44 (Cal CEB 2007); Office Leasing: Drafting and Negotiating the Lease, chap 28 (Cal CEB 1996)). When the seller provides financing in a junior position, a subordination agreement is required to confirm the priorities of the first lien and the seller's lien.

Following are the four California Land Title Association (CLTA) forms of subordination agreement:

- Subordination of Deed of Trust to Additional Loan Under Prior Deed of Trust;
- Subordination of Deed of Trust to Deed of Trust to Record;
- Subordination, Concurrently Recorded Deeds of Trust, One to the Other; and
- Subordination Leasehold Estate to Security Instrument.

These forms can be modified to reflect the specifics of a transaction, but the title company will not prepare these modifications.

PRACTICE TIP: Standard title company forms do not cover many issues that may need to be addressed when a seller is subordinating to a construction loan. Such forms accomplish the subordination on execution and contain no provisions conditioning the subordination on proper application of funds to the construction project. Nor do such forms deal with executory subordinations, which must be custom-drafted. For further discussion of subordination, see California Real Property Sales Transactions §§9.66-9.99 (4th ed Cal CEB 2007).

If the subordination is subject to limiting conditions, the insurer may add the subordination, noting its conditional nature, to the list of title exceptions in Schedule B of the lender's policy. The lender will generally object to the exception because of its unwillingness to make the loan unless it is clearly and unconditionally in the first position. The lender does not want to accept the risk that, following a foreclosure, the subordinating entity may assert that a condition has not been met. The title company may be willing to remove the subordination from Schedule B on lender's objection.

The court in *Swiss Property Mgmt. Co. v Southern Cal. IBEW NECA Pension Plan* (1997) 60 CA4th 839, 70 CR2d 587, found that if the standard and unmodified CLTA subordination agreement form was signed, notwithstanding conditions to subordination contained in the seller's trust deed, the subordination was binding to establish the priority of a third party institutional lender over the seller's deed of trust.

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§15.4 III. DANGER OF ILLEGAL PRACTICE OF LAW

Although a title company may prepare documents following the parties' instructions, it may not give legal advice. *Wilkinson v Rives* (1981) 116 CA3d 641, 172 CR 254. For a review of which title company activities amount to the practice of law, see Anno, *Title Examination Activities by Lending Institution, Insurance Company or Title Abstract Company as Illegal Practice of Law*, 85 ALR2d 184 (1962).

NOTE: At one time, the State Bar of California entered into a treaty with title companies delineating which activities would not constitute the illegal practice of law. That treaty has lapsed. Printed instructions on title company forms may advise the parties to seek advice of counsel.

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IV. ESCROW SERVICES

§15.5 A. Escrow Instructions

Title insurers and underwritten title companies often act as escrow agents on real property transactions. In this role, they normally act as a limited agent rather than a general agent because their only obligation is to comply with the parties' instructions. *Siegel v Fidelity Nat'l Title Ins. Co.* (1996) 46 CA4th 1181, 1193, 54 CR2d 84; *Axley v Transamerica Title Ins. Co.* (1978) 88 CA3d 1, 151 CR 570; *Lee v Title Ins. & Trust Co.* (1968) 264 CA2d 160, 70 CR 378. See §§11.47, 12.56.

Simply because an escrow is conducted by a title company, the parties should not assume that they will obtain the correct title policy unless the escrow agent is properly instructed. In *Axley v Transamerica Title Ins. Co., supra,* the seller's escrow instructions directed the title company to provide the seller with an insured deed of trust on certain designated property, which was not, however, the property she was selling. There was no liability on the part of the agent, however, because although the seller did not obtain the coverage she intended, she did obtain what she had requested. Accordingly, care should be taken to correctly describe in the escrow instructions the type of title insurance coverage desired.

PRACTICE TIP: Although a party may give oral instructions (*Zang v Northwestern Title Co.* (1982) 135 CA3d 159, 185 CR 176), providing written instructions is better practice and will simplify proof of the escrow instructions. See §10.5. See also *Claussen v First Am. Title Guar. Co.* (1986) 186 CA3d 429, 230 CR 749.

If the escrow agent, without proper instructions, pays a third party demand that is due, the agent is not liable or is liable only for nominal damages for failure to comply with instructions. *Mains v City Title Ins. Co.* (1949) 34 C2d 580, 585, 212 P2d 873.

WARNING: If a party to a real estate transaction executes and delivers documents to the escrow agent to be used on satisfaction of specific conditions precedent, the escrow agent might improperly use those documents before there has been strict compliance with the escrow instructions. The unauthorized use of documents or the premature disbursement of funds by the escrow agent can be caused by number of factors (*i.e.*, a defalcation by an employee, negligence by an employee). See, *e.g., Moe v Transamerica Title Ins. Co.* (1971) 21 CA3d 289, 98 CR 547. The consequences to the party whose documents or funds have been used in an unauthorized manner can be significant. This problem can be further exacerbated if a third party, either a bona fide purchaser for value without notice or a bona fide encumbrancer for value without notice, detrimentally relies on the unauthorized delivery of the documents or funds. The potential for such problems emphasizes the need for careful selection of the escrow agent. The agent should not only have the skill and integrity to perform the tasks, but also the financial resources to respond in the event of an unauthorized delivery. The attorney may want to obtain a closing protection letter from the title insurer that underwrites a small, independent escrow agent. See §§3.5, 10.7.

On failure to comply with escrow instructions, see §§11.47, 11.121. On title instructions, see chap 10. For complete discussion of escrow and escrow instructions, see California Real Property Sales Transactions, chap 15 (4th ed Cal CEB 2007).

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B. Potential Ethical Problems for Escrow Holders

§15.6 1. "Silent" Liens

Both residential and commercial lenders sometimes require that the property securing the loan not be encumbered by junior liens. A prospective borrower may suggest to the proposed junior lender that there be a "silent" or unrecorded second lien to avoid an obvious violation of a restriction on junior encumbrances. Nonetheless, even an unrecorded junior encumbrance may be a violation of the loan documents.

This silent lien may also be a material nondisclosure in relation to the prospective lender, giving rise to possible claims of fraud not only against the borrower but also against the title or escrow company if the lender's escrow instructions clearly prohibit secondary financing. Claims of fraud are particularly likely if the borrower records the second security device immediately after the close of escrow. An attorney should not expect a title company to cooperate in a subsequent recordation, even within a short period of time following the loan transaction. Escrow agents who knowingly participate in the creation of a "silent second" can be subject to significant sanctions. They can be prohibited from further work on federally related loan transactions, which means almost any real estate loan other than a loan from a private party. See the Program Fraud Civil Remedies Act (31 USC §§3801-3812), which gives HUD and other agencies the authority to impose civil penalties for false statements and false claims. Regulations give HUD the power to bar anyone from participating in any federal program. 24 CFR pt 24.

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§15.7 2. Deposits

A buyer may attempt to persuade the escrow holder to hold the deposit under the purchase agreement uncashed. Such a request cannot, however, be honored by the escrow holder. All money delivered into escrow must be deposited in a bank, a state or federal savings bank, a state or federal savings association, or an industrial loan company insured by the FDIC and approved by the state real estate commissioner. Fin C §17409; Ins C §12413.1. On regulation of escrow companies, see §1.12; California Real Property Sales Transactions, chap 15 (4th ed Cal CEB 2007).

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§15.8 3. Broker's Commissions

A seller may instruct the escrow holder not to pay a real estate commission at close of escrow. This instruction can create a dilemma for the escrow holder who is required to close if the seller orders. Because the broker is not a party to the escrow, the escrow agent is obligated to follow the instructions of the seller even if the instruction is given after the close of escrow.

An exception to this rule exists if the escrow agent has actual knowledge of an assignment by the seller of the escrow proceeds for payment of the commission. See *Contemporary Investments v Safeco Title Ins. Co.* (1983) 145 CA3d 999, 193 CR 822. See also California Real Property Sales Transactions, chap 15 (4th ed Cal CEB 2007).

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§15.9 V. ACCOMMODATION RECORDINGS

On occasion, a title company is requested to present a document that is not related to any pending transaction for recordation to the recorder's office. Such recordings are called "accommodation recordings." It is difficult to generalize how a particular company will respond to such a request because the practice varies among companies. Some title companies will only do accommodation recordings for regular customers. A number of companies, however, will require that the person requesting transmittal of the document to the recorder provide written instructions together with the appropriate fee for the recorder's office. These accommodation instructions typically state that no insurance is requested and are accompanied by an indemnity agreement providing that the recording is made without liability to the company. See *Rooz v Kimmel* (1997) 55 CA4th 573, 64 CR2d 177. See also §11.46.

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§15.10 VI. TRUSTEE'S DUTIES

Title insurers regularly act as trustees on deeds of trust when they provide preprinted forms of deeds of trust for transactions. Even a deed of trust drafted by an attorney often names the title company handling the transaction as the trustee, unless the attorney's client is a financial institution that has established an auxiliary corporation to act as trustee on its own deeds of trust.

A trustee of a deed of trust is considered to be more of a common agent than a true trustee (*Lupertino v Carbahal* (1973) 35 CA3d 742, 111 CR 112; *Woodworth v Redwood Empire Sav. & Loan* (1971) 22 CA3d 347, 99 CR 373) and is not bound by the fiduciary duties of a trustee of an express trust (*Monterey S.P. Partnership v W.L. Bangham, Inc.* (1989) 49 C3d 454, 261 CR 587). Accordingly, few trustee obligations apply to the trustee of a deed of trust. *Hatch v Collins* (1990) 225 CA3d 1104, 275 CR 476; *Stephens, Partain & Cunningham v Hollis* (1987) 196 CA3d 948, 242 CR 251. The trustee's duties are generally set forth in the deed of trust.

Because no case establishes an affirmative duty by the trustee of a deed of trust to act for the beneficiary, title companies are loose about being named as trustee. The two most significant duties undertaken by trustees are reconveying the deed of trust and processing a nonjudicial foreclosure sale. On reconveyance, see California Mortgages, Deeds of Trust, and Foreclosure Litigation §§8.92-8.99 (4th ed Cal CEB 2009).

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§15.11 A. Potential Problems Arising From Reconveyance of Deed of Trust

Reconveyance of a deed of trust generally presents few problems. The beneficiary must request the trustee to reconvey its deed of trust after the deed of trust has been satisfied. CC §2941. The trustee must accomplish this reconveyance within 21 days after receipt of the note, deed of trust, and request for reconveyance. Civil Code §2941.7 provides a series of steps to be taken by the borrower if:

- Either the beneficiary or the trustee fails to comply with the borrower's request;
- The borrower is unable to locate the beneficiary after a diligent search; or
- The beneficiary is deceased.

For a case interpreting the hierarchical system for reconveyance created by CC §2941, see *Trustors Sec Serv. v Title Recon Tracking Serv.* (1996) 49 CA4th 592, 56 CR2d 793. See also §2.10; California Mortgages, Deeds of Trust, and Foreclosure Litigation §§8.92-8.99 (4th ed Cal CEB 2009).

Special issues arise when there are multiple beneficiaries under the deed of trust. If the beneficiaries have entered into a service agreement with secondary loan brokers acting as a servicing agent, the service agreement may permit the servicing agent to issue requests for reconveyance and even to receive the amount due at the time of reconveyance directly. Title companies have found themselves involved in lawsuits when the servicing agent has filed for bankruptcy after the loan has been paid and the deed of trust reconveyed but before the servicing agent has paid the beneficiaries. As a result, title companies may not accept a request for reconveyance from a servicing agent or may refuse to pay funds directly to it.

PRACTICE TIP: When dealing with a service agreement, the attorney should confirm with the title company its specific requirements for reconveyance. Some title companies may request a notarized request for reconveyance if it comes from the servicing agent. Some may refuse to pay the proceeds to the servicing agent without separate instructions from the beneficiary consenting to such a payoff.

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§15.12 1. Failure of Beneficiary to Execute Reconveyance

If a full reconveyance has not been executed within 75 days after the date on which the obligation was satisfied, a title company may record a release of the obligation after first giving the trustee and the beneficiary 10 days' notice of its intent to do so. Generally, a title company will do so only if its own in-house escrow department has made the payoff.

Although CC §2941(b)(3) provides some assistance, the beneficiary's failure to cooperate can cause a borrower to lose financing due to the delay because most loan commitments expire before the 85-day period has run. The Civil Code holds a noncooperating beneficiary liable to the borrower for all damages resulting from the failure to reconvey and includes a penalty of $500 (see CC §2941(d)), but this may prove to be an inadequate remedy as a practical matter because a refinance or sale may be lost as a result of the beneficiary's failure to act. See also *Pintor v Ong* (1989) 211 CA3d 837, 259 CR 577.

PRACTICE TIP: If the beneficiary is a financial institution (rather than an individual or other nonfinancial institution lender) and if the deed of trust is paid off through escrow, the title company is likely to insure over the prior deed of trust until the reconveyance or a release of the obligation is recorded.

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§15.13 2. Failure to Locate Trustee

The trustor may substitute a new trustee if the present trustee cannot be located after a diligent search (as defined by the statute). CC §2941.7. The trustor must prepare and record a declaration to this effect, a title company must agree to act as the substitute trustee, and the trustor must obtain a corporate bond for the benefit of the lender for a period of 5 years or more in an amount equal to two times the face amount of the deed of trust.

PRACTICE TIP: If the trustee is not cooperative, the beneficiary can (without the consent of the trustee or trustor) substitute a new trustee by recording a substitution of trustee. Title companies have preprinted forms for this purpose. The beneficiary may name itself as the new trustee. *More v Calkins* (1892) 95 C 435, 30 P 583.

On substitution of trustees, see §15.15; California Mortgages, Deeds of Trust, and Foreclosure Litigation §§1.41, 2.21-2.25 (4th ed Cal CEB 2009).

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§15.14 3. Failure to Locate Note or Deed of Trust

A beneficiary is required to deliver the original note and deed of trust or other documents necessary for the reconveyance on request. CC §2941(b)(1). If the original note or deed of trust cannot be located, the title company may require the beneficiary to furnish a lost instrument indemnity bond. See *Huckell v Matranga* (1979) 99 CA3d 471, 160 CR 177.

NOTE: Sometimes a title company will accept a lost note affidavit rather than require a lost instrument bond. This may occur if the lost instrument is old, some evidence of payment of the note exists (*e.g.*, canceled checks), or the note amount is small.

The trustee is required to return the original note and deed of trust to the trustor on reconveyance of the deed of trust on written request. CC §2941(b)(1)(C). A willful violation of the provisions of CC §2941 is a misdemeanor punishable by fine and/or imprisonment. CC §2941.5. Note, however, that some title companies' standard form deeds of trust may provide for the trustee's retention of the note and deed of trust. See California Mortgages, Deeds of Trust, and Foreclosure Litigation §8.94 (4th ed Cal CEB 2009).

If a deed of reconveyance is executed by the trustee without authorization, it is void because it is in excess of the trustee's powers. See *Wutzke v Bill Reid Painting Serv., Inc.* (1984) 151 CA3d 36, 40, 198 CR 418. The fact that a reconveyance is invalid will not, however, protect the original beneficiary to the extent that a bona fide encumbrancer for value relies on the unauthorized reconveyance.

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B. Foreclosure of Deed of Trust

§15.15 1. Substituting Trustee

Many title companies are unwilling to continue to act as a trustee during the foreclosure of a deed of trust because of the high liability attendant to the process. If a trustee is unwilling to act, the beneficiary will substitute a new trustee before recordation of the notice of default. The beneficiary may even act as its own trustee. *More v Calkins* (1892) 95 C 435, 30 P 583.

Substitution of the trustee is not always simple for deeds of trust with multiple beneficiaries who cannot come to a consensus on who should serve as the new trustee if the original trustee refuses to act. Civil Code §2934a establishes procedures for 50 percent of multiple beneficiaries to execute a substitution of trustee. For further discussion of substitution of trustees, see California Mortgages, Deeds of Trust, and Foreclosure Litigation §§1.41, 2.21-2.25 (4th ed Cal CEB 2009).

PRACTICE TIP: When there are multiple beneficiaries of a deed of trust, the beneficiaries should add a provision to the deed of trust detailing the method to be used to substitute the trustee if they do not unanimously agree on the substitution. Multiple beneficiaries can also use a note administration agreement to address this issue. The note administrator (who is not usually a party to the deed of trust) can be empowered to perform the substitution if a certain percentage of beneficiaries approve the substitution. For further discussion of multiple beneficiary proceedings, see Mortgage Deed of Trust Foreclosure §§1.46, 2.24, 2.34.

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§15.16 2. Instituting Nonjudicial Foreclosure

Foreclosure by the trustee under a deed of trust is normally instituted by the beneficiary of the deed of trust by giving the trustee a written demand for foreclosure setting forth the nature and extent of the default. *California Trust Co. v Smead Inv. Co.* (1935) 6 CA2d 432, 44 P2d 624. Generally, a title company, when acting as trustee under a deed of trust, will institute nonjudicial foreclosure proceedings only when it is satisfied that there is a default of a nature and extent entitling the beneficiary to institute foreclosure. See *Baypoint Mortgage Corp. v Crest Premium Real Estate Investments Retirement Trust* (1985) 168 CA3d 818, 214 CR 531.

Accordingly, it is not unusual for the trustee to decline to institute nonjudicial foreclosure proceedings when the beneficiary desires to have them instituted for a nonmonetary default (*e.g.*, waste). Although a beneficiary may file suit to require the trustee to institute foreclosure proceedings or to have the court appoint a new trustee, this problem is normally resolved simply by the beneficiary's substituting a trustee who is willing to undertake the foreclosure proceedings. *Smith v Davis* (1891) 90 C 25, 27 P 26. See §15.15.

NOTE: Title companies do not institute judicial foreclosures.

When a nonjudicial sale is being conducted, a trustee's sale guaranty should be obtained. Its purpose is to ensure the accuracy of certain information provided to the trustee and beneficiary of the deed of trust in conducting a trustee's sale of the property. On trustee's sale guaranties generally, see §§9.6-9.8. On trustee sales generally, see California Mortgages, Deeds of Trust, and Foreclosure Litigation, chap 2 (4th ed Cal CEB 2009).

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§15.17 3. Conducting the Sale

The trustee's duties in conducting the foreclosure sale are generally found in both the provisions of the deed of trust and CC §§2924-2924k. For full discussion of the trustee sale and the trustee's duties, see California Mortgages, Deeds of Trust, and Foreclosure Litigation, chap 2 (4th ed Cal CEB 2009).

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Source: Real Property/California Title Insurance Practice/15 Additional Title Company Services/§15.18 VII. TRUST COMPANY SERVICES

§15.18 VII. TRUST COMPANY SERVICES

Some title insurance companies conduct a trust company business through wholly owned subsidiary companies. (Previously, some title insurance companies offered these services directly, but that is no longer permitted since the enactment of Stats 1996, ch 1063, which prohibits title insurance companies from acting as trust companies.)

Following are the more common services provided by these subsidiary trust companies:

- Performing escrow services not connected with the issuance of title insurance;
- Acting as a qualified intermediary for a tax-deferred exchange; and
- Holding title under a holding agreement on behalf of the fee owner.

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§15.19 VIII. CUSTOMER SERVICE

A title company's customer service department can be a helpful resource for quickly obtaining information such as the name of an owner of a parcel of property or a copy of a recorded document. This free information is usually available while the requestor remains on the telephone. Brokers use the information obtained from this service to solicit the listing of property, and attorneys use it to begin tracing chain of title. Because this information is furnished without any analysis or guaranty, attorneys should not rely on it without following up with the purchase of appropriate title insurance or a chain of title guaranty, which can be a source of recovery if it is in error. On chain of title guaranties, see §9.18.

In many areas, the customer service department will, on request, send a property profile that includes a copy of the last deed and deed of trust as well as assessment information about the property. Because this information is free and furnished without guaranty, the profile will probably contain liability disclaimers and should not be relied on other than as a handy starting point. See also §3.15.

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Source: Real Property/California Title Insurance Practice/15 Additional Title Company Services/§15.20 IX. OTHER SERVICES

§15.20 IX. OTHER SERVICES

Title companies may also perform one or more of the following services:

- Acting as a registrar or transfer agent of the State of California or any political subdivision in the state or of any public or private corporation. Ins C §12391(a).
- Acting as a transfer agent for, or countersign any evidence of, indebtedness that it may insure. Ins C §12391(b).
- Acting as the transfer agent for, or countersign certificates of stocks of, any public or private corporation. Ins C §12391(c).
- If authorized to conduct business as a trust company, acting as a conservator if the title company's articles of incorporation permit. Ins C §12392.
- Assisting developers in processing subdivisions or other special projects.
- Acting, through means of a wholly owned subsidiary, as a qualified intermediary for tax-deferred exchanges. On qualified intermediaries generally, see Real Property Exchanges, chaps 1-2, 4 (3d ed Cal CEB 2002).

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Source: Real Property/California Title Insurance Practice/Appendix A ALTA Closing Protection Letter and Explanation (Revised March 27, 1987)

Appendix A

ALTA Closing Protection Letter and Explanation (Revised March 27, 1987)

BLANK TITLE INSURANCE COMPANY

Name and Address of Addressee Date:

Re: Closing Protection Letter

Dear:

When title insurance of Blank Title Insurance Company is specified for your protection in connection with closings of real estate transactions in which you are to be the lessee or purchaser of an interest in land or a lender secured by a mortgage (including any other security instrument) of an interest in land, the Company, subject to the Conditions and Exclusions set forth below, hereby agrees to reimburse you for actual loss incurred by you in connection with such closings when conducted by an Issuing Agent (an agent authorized to issue title insurance for the Company) or an Approved Attorney (an attorney upon whose certification of title the Company issues title insurance) and when such loss arises out of:

1. Failure of the Issuing Agent or Approved Attorney to comply with your written closing instructions to the extent that they relate to (a) the status of the title to said interest in land or the validity, enforceability and priority of the lien of said mortgage on said interest in land, including the obtaining of documents and the disbursement of funds necessary to establish such status of title or lien, or (b) the obtaining of any other document, specifically required by you, but not to the extent that said instructions require a determination of the validity, enforceability or effectiveness of such other document, or (c) the collection and payment of funds due you, or
2. Fraud or dishonesty of the Issuing Agent or Approved Attorney in handling your funds or documents in connection with such closings.

If you are a lender protected under the foregoing paragraph, your borrower in connection with a loan secured by a mortgage on a one to four family dwelling shall be protected as if this letter were addressed to your borrower.

Conditions and Exclusions

A. The Company will not be liable to you for loss arising out of:
   1. Failure of the Approved Attorney to comply with your closing instructions which require title insurance protection inconsistent with that set forth in the title insurance binder or commitment issued by the Company. Instructions which require the removal of specific exceptions to title or compliance with the requirements contained in said binder or commitment shall not be deemed to be inconsistent.
   2. Loss or impairment of your funds in the course of collection or while on deposit with a bank due to bank failure, insolvency or suspension, except such shall result from failure of the Issuing Agent or the Approved Attorney to comply with your written closing instructions to deposit the funds in a bank which you designated by name.
   3. Mechanics' and materialmen's liens in connection with your purchase or lease or construction loan transactions, except to the extent that protection against such liens is afforded by a title insurance binder, commitment or policy of the Company.

B. If the closing is to be conducted by an Approved Attorney, a title insurance binder or commitment for the issuance of a policy of title insurance of the Company must have been received by you prior to the transmission of your final closing instructions to the Approved Attorney.

C. When the Company shall have reimbursed you pursuant to this letter, it shall be subrogated to all rights and remedies which you would have had against any person or property had you not been so reimbursed. Liability of the Company for such reimbursement shall be reduced to the extent that you have knowingly and voluntarily impaired the value of such right of subrogation.

D. Any liability of the Company for loss incurred by you in connection with closings of real estate transactions by an Issuing Agent or Approved Attorney shall be limited to the protection provided by this letter. However, this letter shall not affect the protection afforded by a title insurance binder, commitment or policy of the Company.

E. Claims shall be made promptly to the Company at its principal office at _ _ _ _ _ _. When the failure to give prompt notice shall prejudice the Company, then liability of the Company hereunder shall be reduced to the extent of such prejudice.

F. The protection herein offered does not extend to real property transactions in

The protection herein offered will be effective upon receipt by the Company of your acceptance in writing, which may be made on the enclosed copy hereof and will continue until canceled by written notice from the Company.

Any previous insured closing service letter or similar agreement is hereby canceled except as to closings of your real estate transactions regarding which you have previously sent or within 30 days hereafter send written closing instructions to the Issuing Agent or Approved Attorney.

BLANK TITLE INSURANCE COMPANY

BY: _____

_____

(Title)

Accepted: _ _ _ _ _ _, 19_ _

By: _____

(Title)

(The name of a particular issuing agent or approved attorney may be inserted in lieu of reference to Issuing Agent or Approved Attorney contained in this letter and the words "Underwritten Title Company" may be inserted in lieu of Issuing Agent)

ALTA CLOSING PROTECTION LETTER-A REVISED EXPLANATION

As title insurance companies spread across the country, they transacted business through issuing agents as well as through their branch offices. Where they did not have title examination facilities in their offices or agencies, they relied on so-called "approved attorneys" for title evidence.

In approaching their customers — especially national customers — for business, title insurers asked that orders for policies be sent not only to their branches, but also to issuing agents or through approved attorneys.

These issuing agents and approved attorneys furnished loan closing services and it was suggested that the national lender or purchaser not only get title insurance protection in the locality, but escrow closing service as well, from the issuing agent or approved attorney.

Customers naturally raised the question as to what liability, if any, the title insurer might have, outside of its policy, for loss suffered due to the issuing agent's or approved attorney's mishandling of the funds in closing the transaction.

It was evident that the approved attorney was not appointed by the title company as its agent for any purpose but was merely approved as being an acceptable source of a title opinion on which the insurer would rely for issuance of its policies. The issuing agent was expressly authorized by contract to act only as agent for issuing title policies. Therefore, it became apparent that neither closing media has express authority to handle closings as an agent of the title insurer with the resulting liability for negligence or fraud.

The doctrine of apparent authority was not very helpful either, since that legal precept depended on the lender or purchaser being able to prove that he had justifiably relied on the conduct of the title insurer to mislead him into thinking that the issuing agent or approved attorney was closing the transaction as an agent of the title company. This made the liability of the title insurer for such closings uncertain since each case turned on the facts and the law as applied in different jurisdictions.

For these reasons, investors in real estate asked for definite undertakings from title insurers setting forth in writing the extent of their responsibility for errors in closing on the part of their issuing agents and approved attorneys. The title companies responded with numerous forms of closing protection letters furnishing coverage in different degrees. The result is that a national lender, for example, has received closing indemnities differing in protection not only from insurer to insurer, but from state to state or from time to time as issued by the same insurer.

The Executive Committee of the American Land Title Association decided it would be helpful to promulgate an association form which would provide a carefully drafted statement, which, on due consideration, might be acceptable to insurer and insured.

The opening paragraph of the ALTA Closing Protection Letter furnishes protection to purchasers, lessees and lenders when closings are conducted by the title company's issuing agents or approved attorneys.

Under Paragraph 1, the protection is against loss or damage arising from failure to follow the addressee's written closing instructions. The failure may relate first to instructions dealing with the status of the title to the land or the lien of the mortgage. This item includes the obtaining of documents necessary to establish such status of title or lien.

Secondly, the instructions covered may also relate to the obtaining of any other documents, even though they do not relate to status of title or lien, but not to instructions requiring the issuing agent or approved attorney to determine whether these other documents are necessary or whether they are properly drafted. In other words, under Item 1.(b), instructions to obtain a certain type or form of non-title document are covered, but instructions to ascertain that a non-title document is valid, enforceable or effective are not covered.

Thirdly, instructions which relate to the collections and payment of funds due the addressee are covered, regardless of the type of funds or from where they are to be collected.

In an effort to provide protection to the homeowner, the letter, when addressed to a lender, will be deemed to have been addressed to its residential borrower, thus covering the homeowner as if he had the letter.

Paragraph 2 protects against dishonesty in handling the addressee's funds or documents. Any fraudulent use of money or of documents belonging to the addressee would be covered.

Item A.1 of the Conditions and Exclusions excludes liability when the addressee, after issuance of a binder or commitment, issues instructions to an approved attorney requiring title insurance coverage different from the coverage committed for in the binder or commitment. The approved attorneys, unlike issuing agents, may not be knowledgeable regarding title insurance underwriting and should not be in a position to, in effect, commit for additional coverage by closing the transaction. The title insurer should be requested to amend the binder or commitment prior to closing. However, instructions relating to removal of specific exceptions or compliance with requirements are covered.

Under Item A.2 the title insurer is not liable for bank failures unless the closing funds are deposited in a bank different from the bank specified by name.

Item A.3 makes it clear that if the title insurer does not have liability for mechanics' liens in its title insurance documents, then it does not incur such liability in the Closing Protection Letter.

Paragraph B. conditions the coverage on the addressee having received a commitment or binder before he permits an approved attorney to close the transaction. This ties in with Item A.1 and permits the lender or purchaser to know what title insurance coverage he can obtain before he authorizes the attorney to disburse his funds.

Item C., D. and E. are standard indemnity contract provisions and are self explanatory.

Paragraph F. makes the letter inapplicable to states as indicated by the Company.

The protection furnished by the letter becomes effective when the addressee signs and returns the letter. It can be canceled only by written notice.

The last paragraph cancels previous letters except as to instructions already sent or sent within 30 days.

If the customer requires a closing protection letter regarding a particular issuing agent or approved attorney, the name may be inserted in the letter in place of the general reference.

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Source: Real Property/California Title Insurance Practice/Appendix B CLTA Interim Binder Form A (Revised February 19, 1981)

Appendix B

CLTA Interim Binder Form A (Revised February 19, 1981)

INTERIM BINDER FORM A

BLANK TITLE INSURANCE COMPANY

To: Fee: $_____

Date of Binder: No.

BLANK TITLE INSURANCE COMPANY, a corporation, hereby agrees that it will issue, as of the date shown above, its _____ policy of title insurance (with CLTA Endorsement No. ____ attached*) with a liability not exceeding $_____, insuring title to the estate or interest described to be vested in the vestee named herein subject only to the exceptions shown herein and to all of the provisions of the policy; or in the alternative, if a valid and sufficient instrument creating an insurable estate, interest or lien in favor of _____ is executed, delivered and recorded within ____ days from the date shown above, the policy will be issued as of the date of recording the instrument, insuring the estate, interest or lien subject only to the aforesaid exceptions and provisions of the policy and to liens, encumbrances and any other matters affecting title which shall have intervened, or occurred, or become for the first time disclosed of record between the date shown above and the date of recording the instrument, including those matters affecting title which may attach as a result of the recording.

This Binder is null and void ____ days from the date shown above or when the policy is issued, whichever shall first happen.

BLANK TITLE INSURANCE COMPANY

By _____

President

By _____

Secretary

SCHEDULE A

1. The estate or interest in the land described or referred to herein is:
2. Title to the estate or interest covered hereby at the date hereof is vested in:
3. The land referred to herein is described as follows:
4. Exceptions:

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Source: Real Property/California Title Insurance Practice/Appendix C CLTA Preliminary Report Form (1995)

Appendix C

CLTA Preliminary Report Form (1995)

BLANK TITLE COMPANY
PRELIMINARY REPORT

Your No.

Our No.

TO:

In response to the above referenced application for a policy of title insurance, Blank Title Company hereby reports that it is prepared to issue, or cause to be issued, as of the date hereof, a Policy or Policies of Title Insurance describing the land and the estate or interest therein hereinafter set forth, insuring against loss which may be sustained by reason of any defect, lien or encumbrance not shown or referred to as an Exception below or not excluded from coverage pursuant to the printed Schedules, Conditions and Stipulations of said Policy forms.

The printed Exceptions and Exclusions from the coverage of said Policy or Policies are set forth in Exhibit A attached. Copies of the Policy forms should be read. They are available from the office which issued this report.

Please read the exceptions shown or referred to below and the exceptions and exclusions set forth in Exhibit A of this report carefully. The exceptions and exclusions are meant to provide you with notice of matters which are not covered under the terms of the title insurance policy and should be carefully considered.

It is important to note that this preliminary report is not a written representation as to the condition of title and may not list all liens, defects, and encumbrances affecting title to the land.

This report (and any supplements or amendments hereto) is issued solely for the purpose of facilitating the issuance of a policy of title insurance and no liability is assumed hereby. If it is desired that liability be assumed prior to the issuance of a policy of title insurance, a Binder or Commitment should be requested.

Dated as of , 19 , at 7:30 A.M.

Title Officer

The form of policy of title insurance contemplated by this report is: .

The estate or interest in the land hereinafter described or referred to covered by this Report is:

.

Title to said estate or interest at the date hereof is vested in: .

The land referred to in this Report is situated in the State of California, County of ,

and is described as follows: .

At the date hereof exceptions to coverage in addition to the printed Exceptions and Exclusions in said policy form would be as follows: .

CLTA Preliminary Report Form (Rev. 1-1-95)

Exhibit A (Rev. 12-04-92)*

CALIFORNIA LAND TITLE ASSOCIATION
STANDARD COVERAGE POLICY-1990
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 or zoning laws, ordinances, or regulations) restricting, regulating, prohibiting or relating (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 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) whether or not recorded in the public records at Date of Policy, but 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 insured mortgage or for the estate or interest insured by this policy.

4. Unenforceability of the lien of the insured mortgage because of the inability or failure of the insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with the applicable doing business laws of the state in which the land is situated.
5. Invalidity or unenforceability of the lien of the insured mortgage, or claim thereof, which arises out of the transaction evidenced by the insured mortgage and is based upon usury or any consumer credit protection or truth in lending law.
6. Any claim, which arises out of the transaction vesting in the insured the estate of interest insured by this policy or the transaction creating the interest of the insured lender, by reason of the operation of federal bankruptcy, state insolvency or similar creditors' rights laws.

EXCEPTIONS FROM COVERAGE-SCHEDULE B, PART I

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. Taxes or assessments which are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the public records.

   Proceedings by a public agency which may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the public records.
2. Any facts, rights, interests, or claims which are not shown by the public records but which could be ascertained by an inspection of the land which may be asserted by persons in possession thereof.
3. Easements, liens or encumbrances, or claims thereof, which are not shown by the public records.
4. Discrepancies, conflicts in boundary lines, shortage in area, encroachments, or any other facts which a correct survey would disclose, and which are not shown by the public records.
5. (a) Unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims or title to water, whether or not the matters excepted under (a), (b) or (c) are shown by the public records.

AMERICAN LAND TITLE ASSOCIATION
RESIDENTIAL TITLE INSURANCE POLICY (6-1-87)
EXCLUSIONS

In addition to the Exceptions in Schedule B, you are not insured against loss, costs, attorneys' fees, and expenses resulting from:

1. Governmental police power, and the existence or violation of any law or government regulation. This includes building and zoning ordinances and also laws and regulations concerning:

   land use

   improvements on the land

   land division

   environmental protection

   This exclusion does not apply to violations or the enforcement of these matters which appear in the public records at Policy Date.

   This exclusion does not limit the zoning coverage described in Items 12 and 13 of Covered Title Risks.
2. The right to take the land by condemning it, unless:

   a notice of exercising the right appears in the public records

   on the Policy Date

   the taking happened prior to the Policy Date and is binding on you if you bought the land without knowing of the taking
3. Title Risks:

   that are created, allowed, or agreed to by you

   that are known to you, but not to us, on the Policy Date — unless they appeared in the public records

   that result in no loss to you

   that first affect your title after the Policy Date — this does not limit the labor and material lien coverage in Item 8 of Covered Title Risks
4. Failure to pay value for your title.
5. Lack of a right:

   to any land outside the area specifically described and referred to in Item 3 of Schedule A

   OR

   in streets, alleys, or waterways that touch your land

   This exclusion does not limit the access coverage in Item 5 of Covered Title Risks.

AMERICAN LAND TITLE ASSOCIATION LOAN POLICY (10-17-92)
WITH ALTA ENDORSEMENT-FORM 1 COVERAGE
and
AMERICAN LAND TITLE ASSOCIATION LEASEHOLD LOAN POLICY (10-17-92)
WITH ALTA ENDORSEMENT-FORM 1 COVERAGE
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 (except to the extent that this policy insures the priority of the lien of the insured mortgage over any statutory lien for services, labor or material or to the extent insurance is afforded herein as to assessments for street improvements under construction or completed at 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 insured mortgage.

4. Unenforceability of the lien of the insured mortgage because of the inability or failure of the insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with applicable doing business laws of the state in which the land is situated.

5. Invalidity or unenforceability of the lien of the insured mortgage, or claim thereof, which arises out of the transaction evidenced by the insured mortgage and is based upon usury or any consumer credit protection or truth in lending law.

6. Any statutory lien for services, labor or materials (or the claim of priority of any statutory lien for services, labor or materials over the lien of the insured mortgage) arising from an improvement or work related to the land which is contracted for and commenced subsequent to Date of Policy and is not 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.

7. Any claim, which arises out of the transaction creating the interest of the mortgagee insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that is based on:

(i) the transaction creating the interest of the insured mortgagee being deemed a fraudulent conveyance or fraudulent transfer; or

(ii) the subordination of the interest of the insured mortgagee as a result of the application of the doctrine or equitable subordination; or

(iii) the transaction creating the interest of the insured mortgagee being deemed a preferential transfer except where the preferential transfer results from the failure:

(a) to timely record the instrument of transfer; or

(b) of such recordation to impart notice to a purchaser for value or a judgment or lien creditor.

The above policy forms may be issued to afford either Standard Coverage or Extended Coverage. In addition to the above Exclusions from Coverage, the Exceptions from Coverage in a Standard Coverage policy will also include the following General Exceptions:

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. Taxes or assessments which are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the public records.

Proceedings by a public agency which may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the public records.

2. Any facts, rights, interests or claims which are not shown by the public records but which could be ascertained by an inspection of the land or by making inquiry of persons in possession thereof.

3. Easements, liens or encumbrances, or claims thereof, which are not shown by the public records.

4. Discrepancies, conflicts in boundary lines, shortage in area, encroachments, or any other facts which a correct survey would disclose, and which are not shown by the public records.

5. (a) Unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims or title to water, whether or not the matters excepted under (a), (b) or (c) are shown by the public records.

AMERICAN LAND TITLE ASSOCIATION OWNER'S POLICY (10-17-92)
and
AMERICAN LAND TITLE ASSOCIATION LEASEHOLD OWNER'S POLICY (10-17-92)
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:

(i) the transaction creating the estate or interest insured by this policy being deemed a fraudulent conveyance or fraudulent transfer; or

(ii) 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:

(a) to timely record the instrument of transfer; or

(b) of such recordation to impart notice to a purchaser for value or a judgment or lien creditor.

The above policy forms may be issued to afford either Standard Coverage or Extended Coverage. In addition to the above Exclusions from Coverage, the Exceptions from Coverage in a Standard Coverage Policy will also include the following General Instructions:

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. Taxes or assessments which are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the public records.

Proceedings by a public agency which may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the public records.

2. Any facts, rights, interests or claims which are not shown by the public records but which could be ascertained by an inspection of the land or by making inquiry of persons in possession thereof.

3. Easements, liens or encumbrances, or claims thereof, which are not shown by the public records.

4. Discrepancies, conflicts in boundary lines, shortage in area, encroachments, or any other facts which a correct survey would disclose, and which are not shown by the public records.

5. (a) Unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims or title to water, whether or not the matters excepted under (a), (b) or (c) are shown by the public records.

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Appendix D

CLTA Preliminary Report Form (2004)



BLANK TITLE COMPANY
PRELIMINARY REPORT

Your No._____
Our No._____

TO:

In response to the above referenced application for a policy of title insurance, Blank Title Company hereby reports that it is prepared to issue, or cause to be issued, as of the date hereof, a Policy or Policies of Title Insurance describing the land and the estate or interest therein hereinafter set forth, insuring against loss which may be sustained by reason of any defect, lien or encumbrance not shown or referred to as an Exception below or not excluded from coverage pursuant to the printed Schedules, Conditions and Stipulations of said Policy forms.

The printed Exceptions and Exclusions from the coverage and Limitations on Covered Risks of said Policy or Policies are set forth in Exhibit A attached. Limitations on Covered Risks applicable to the CLTA and ALTA Homeowner's Policies of Title Insurance which establish a Deductible Amount and a Maximum Dollar Limit of Liability for certain coverages are also set forth in Exhibit A. Copies of the Policy forms should be read. They are available from the office which issued this report.

Please read the exceptions shown or referred to below and the exceptions and exclusions set forth in Exhibit A of this report carefully. The exceptions and exclusions are meant to provide you with notice of matters which are not covered under the terms of the title insurance policy and should be carefully considered. It is important to note that this preliminary report is not a written representation as to the condition of title and may not list all liens, defects, and encumbrances affecting title to the land.

This report (and any supplements or amendments hereto) is issued solely for the purpose of facilitating the issuance of a policy of title insurance and no liability is assumed hereby. If it is desired that liability be assumed prior to the issuance of a policy of title insurance, a Binder or Commitment should be requested.

Dated as of _____, 2_____, at 7:30 A.M.

_____
Title Officer

The form of policy of title insurance contemplated by this report is:

The estate or interest in the land hereinafter described or referred to covered by this Report is:

Title to said estate or interest at the date hereof is vested in:

The land referred to in this Report is situated in the State of California, County of _____, and is described as follows:

At the date hereof exceptions to coverage in addition to the printed Exceptions and Exclusions in said policy form would be as follows:

Print

Exhibit A (Revised 11-17-04)

CALIFORNIA LAND TITLE ASSOCIATION
STANDARD COVERAGE POLICY – 1990

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 or zoning laws, ordinances, or regulations) restricting, regulating, prohibiting or relating (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 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) whether or not recorded in the public records at Date of Policy, but 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 insured mortgage or for the estate or interest insured by this policy.

4. Unenforceability of the lien of the insured mortgage because of the inability or failure of the insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with the applicable doing business laws of the state in which the land is situated.

5. Invalidity or unenforceability of the lien of the insured mortgage, or claim thereof, which arises out of the transaction evidenced by the insured mortgage and is based upon usury or any consumer credit protection or truth in lending law.

6. Any claim, which arises out of the transaction vesting in the insured the estate of interest insured by this policy or the transaction creating the interest of the insured lender, by reason of the operation of federal bankruptcy, state insolvency or similar creditors' rights laws.



EXCEPTIONS FROM COVERAGE - SCHEDULE B, PART I

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. Taxes or assessments which are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the public records.

   Proceedings by a public agency which may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the public records.

2. Any facts, rights, interests, or claims which are not shown by the public records but which could be ascertained by an inspection of the land or which may be asserted by persons in possession thereof.

3. Easements, liens or encumbrances, or claims thereof, which are not shown by the public records.

4. Discrepancies, conflicts in boundary lines, shortage in area, encroachments, or any other facts which a correct survey would disclose, and which are not shown by the public records.

5. (a) Unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims or title to water, whether or not the matters excepted under (a), (b) or (c) are shown by the public records.

CLTA HOMEOWNER'S POLICY OF TITLE INSURANCE (10/22/03)
ALTA HOMEOWNER'S POLICY OF TITLE INSURANCE

EXCLUSIONS

In addition to the Exceptions in Schedule B, You are not insured against loss, costs, attorneys' fees, and expenses resulting from:

1. Governmental police power, and the existence or violation of any law or government regulation. This includes ordinances, laws and regulations concerning:

   a. building
   b. zoning
   c. Land use
   d. improvements on the Land
   e. Land division
   f. environmental protection

   This Exclusion does not apply to violations or the enforcement of these matters if notice of the violation or enforcement appears in the Public Records at the Policy Date.

   This Exclusion does not limit the coverage described in Covered Risk 14, 15, 16, 17 or 24.

2. The failure of Your existing structures, or any part of them, to be constructed in accordance with applicable building codes. This Exclusion does not apply to violations of building codes if notice of the violation appears in the Public Records at the Policy Date.

3. The right to take the Land by condemning it, unless:

   a. a notice of exercising the right appears in the Public Records at the Policy Date; or
   b. the taking happened before the Policy Date and is binding on You if You bought the Land without Knowing of the taking.



4. Risks:

   a. that are created, allowed, or agreed to by You, whether or not they appear in the Public Records;
   b. that are Known to You at the Policy Date, but not to Us, unless they appear in the Public Records at the Policy Date;
   c. that result in no loss to You; or
   d. that first occur after the Policy Date - this does not limit the coverage described in Covered Risk 7, 8.d, 22, 23, 24 or 25.

5. Failure to pay value for Your Title.

6. Lack of a right:

   a. to any Land outside the area specifically described and referred to in paragraph 3 of Schedule A; and
   b. in streets, alleys, or waterways that touch the Land.

   This Exclusion does not limit the coverage described in Covered Risk 11 or 18.

LIMITATIONS ON COVERED RISKS

Your insurance for the following Covered Risks is limited on the Owner's Coverage Statement as follows:

- For Covered Risk 14, 15, 16 and 18, Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.

The deductible amounts and maximum dollar limits shown on Schedule A are as follows:

	Your Deductible Amount	Our Maximum Dollar Limit of Liability
Covered Risk 14:	____% of Policy Amount or $ _____ (whichever is less)	$ _____
Covered Risk 15:	____% of Policy Amount or $ _____ (whichever is less)	$ _____
Covered Risk 16:	____% of Policy Amount or $ _____ (whichever is less)	$ _____
Covered Risk 18:	____% of Policy Amount or $ _____ (whichever is less)	$ _____

AMERICAN LAND TITLE ASSOCIATION
RESIDENTIAL TITLE INSURANCE POLICY (6-1-87)

EXCLUSIONS

In addition to the Exceptions in Schedule B, you are not insured against loss, costs, attorneys' fees, and expenses resulting from:

1. Governmental police power, and the existence or violation of any law or government regulation. This includes building and zoning ordinances and also laws and regulations concerning:

   * land use
   * improvements on the land
   * land division
   * environmental protection



This exclusion does not apply to violations or the enforcement of these matters which appear in the public records at Policy Date.

This exclusion does not limit the zoning coverage described in Items 12 and 13 of Covered Title Risks.

2. The right to take the land by condemning it, unless:

   * a notice of exercising the right appears in the public records
   * on the Policy Date
   * the taking happened prior to the Policy Date and is binding on you if you bought the land without knowing of the taking

3. Title Risks:

   * that are created, allowed, or agreed to by you
   * that are known to you, but not to us, on the Policy Date -- unless they appeared in the public records
   * that result in no loss to you
   * that first affect your title after the Policy Date -- this does not limit the labor and material lien coverage in Item 8 of Covered Title Risks

4. Failure to pay value for your title.

5. Lack of a right:

   * to any land outside the area specifically described and referred to in Item 3 of Schedule A

   OR

   * in streets, alleys, or waterways that touch your land

This exclusion does not limit the access coverage in Item 5 of Covered Title Risks.

AMERICAN LAND TITLE ASSOCIATION LOAN POLICY (10-17-92)
WITH ALTA ENDORSEMENT-FORM 1 COVERAGE

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;

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(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 (except to the extent that this policy insures the priority of the lien of the insured mortgage over any statutory lien for services, labor or material or to the extent insurance is afforded herein as to assessments for street improvements under construction or completed at 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 insured mortgage.

4. Unenforceability of the lien of the insured mortgage because of the inability or failure of the insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with applicable doing business laws of the state in which the land is situated.

5. Invalidity or unenforceability of the lien of the insured mortgage, or claim thereof, which arises out of the transaction evidenced by the insured mortgage and is based upon usury or any consumer credit protection or truth in lending law.

6. Any statutory lien for services, labor or materials (or the claim of priority of any statutory lien for services, labor or materials over the lien of the insured mortgage) arising from an improvement or work related to the land which is contracted for and commenced subsequent to Date of Policy and is not 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.

7. Any claim, which arises out of the transaction creating the interest of the mortgagee insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that is based on:

(i) the transaction creating the interest of the insured mortgagee being deemed a fraudulent conveyance or fraudulent transfer; or

(ii) the subordination of the interest of the insured mortgagee as a result of the application of the doctrine or equitable subordination; or

(iii) the transaction creating the interest of the insured mortgagee being deemed a preferential transfer except where the preferential transfer results from the failure:

(a) to timely record the instrument of transfer; or

(b) of such recordation to impart notice to a purchaser for value or a judgement or lien creditor.

The above policy forms may be issued to afford either Standard Coverage or Extended Coverage. In addition to the above Exclusions from Coverage, the Exceptions from Coverage in a Standard Coverage policy will also include the following General Exceptions:

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. Taxes or assessments which are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the public records.

Proceedings by a public agency which may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the public records.



2. Any facts, rights, interests or claims which are not shown by the public records but which could be ascertained by an inspection of the land or which may be asserted by persons in possession thereof.

3. Easements, liens or encumbrances, or claims thereof, which are not shown by the public records.

4. Discrepancies, conflicts in boundary lines, shortage in area, encroachments, or any other facts which a correct survey would disclose, and which are not shown by the public records.

5. (a) Unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims or title to water, whether or not the matters excepted under (a), (b) or (c) are shown by the public records.

AMERICAN LAND TITLE ASSOCIATION OWNER'S POLICY (10-17-92)

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:

   (i) the transaction creating the estate or interest insured by this policy being deemed a fraudulent conveyance or fraudulent transfer; or

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(ii) 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:

(a) to timely record the instrument of transfer; or

(b) of such recordation to impart notice to a purchaser for value or a judgement or lien creditor.

The above policy forms may be issued to afford either Standard Coverage or Extended Coverage. In addition to the above Exclusions from Coverage, the Exceptions from Coverage in a Standard Coverage Policy will also include the following General Exceptions:

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. Taxes or assessments which are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the public records.

   Proceedings by a public agency which may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the public records.

2. Any facts, rights, interests or claims which are not shown by the public records but which could be ascertained by an inspection of the land or which may be asserted by persons in possession thereof.

3. Easements, liens or encumbrances, or claims thereof, which are not shown by the public records.

4. Discrepancies, conflicts in boundary lines, shortage in area, encroachments, or any other facts which a correct survey would disclose, and which are not shown by the public records.

5. (a) Unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims or title to water, whether or not the matters excepted under (a), (b) or (c) are shown by the public records.

ALTA EXPANDED COVERAGE RESIDENTIAL LOAN POLICY (10/13/01)

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 areas 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 s 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. This exclusion does not limit the coverage provided under Covered Risks 12, 13, 14, and 16 of this 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. This exclusion does not limit the coverage provided under Covered Risks 12, 13, 14, and 16 of this 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 (this paragraph does not limit the coverage provided under Covered Risks 8, 16, 18, 19, 20, 21, 22, 23, 24, 25 and 26); or

   (e) resulting in loss or damage which would not have been sustained if the Insured Claimant had paid value for the Insured Mortgage.

4. Unenforceability of the lien of the Insured Mortgage because of the inability or failure of the Insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with applicable doing business laws of the state in which the Land is situated.

5. Invalidity or unenforceability of the lien of the Insured Mortgage, or claim thereof, which arises out of the transaction evidenced by the Insured Mortgage and is based upon usury, except as provided in Covered Risk 27, or any consumer credit protection or truth in lending law.

6. Real property taxes or assessments of any governmental authority which become a lien on the Land subsequent to Date of Policy. This exclusion does not limit the coverage provided under Covered Risks 7, 8(e) and 26.

7. Any claim of invalidity, unenforceability or lack of priority of the lien of the Insured Mortgage as to advances or modifications made after the Insured has Knowledge that the vestee shown in Schedule A is no longer the owner of the estate or interest covered by this policy. This exclusion does not limit the coverage provided in Covered Risk 8.

8. Lack of priority of the lien of the Insured Mortgage as to each and every advance made after Date of Policy, and all interest charged thereon, over liens, encumbrances and other matters affecting the title, the existence of which are Known to the Insured at:

   (a) The time of the advance; or

   (b) The time a modification is made to the terms of the Insured Mortgage which changes the rate of interest charged, if the rate of Interest is greater as a result of the modification than it would have been before the modification. This exclusion does not limit the coverage provided in Covered Risk 8.

9. The failure of the residential structure, or any portion thereof to have been constructed before, on or after Date of Policy in accordance with applicable building codes. This exclusion does not apply to violations of building codes if notice of the violation appears in the Public Records at Date of Policy.

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Source: Real Property/California Title Insurance Practice/Appendix E CLTA Preliminary Report Form (2006)

Appendix E

CLTA Preliminary Report Form (2006)



BLANK TITLE COMPANY
PRELIMINARY REPORT

Your No._____
Our No._____

TO:

In response to the above referenced application for a policy of title insurance, Blank Title Company hereby reports that it is prepared to issue, or cause to be issued, as of the date hereof, a policy or policies of title insurance describing the land and the estate or interest therein hereinafter set forth, insuring against loss which may be sustained by reason of any defect, lien or encumbrance not shown or referred to as an exception below or not excluded from coverage pursuant to the printed Schedules, Conditions and Stipulations of said policy forms.

The printed Exceptions and Exclusions from the coverage and Limitations on Covered Risks of said policy or policies are set forth in Exhibit A attached. The policy to be issued may contain an arbitration clause. When the Amount of Insurance is less than that set forth in the arbitration clause, all arbitrable matters shall be arbitrated at the option of either the Company or the Insured as the exclusive remedy of the parties. Limitations on Covered Risks applicable to the CLTA and ALTA Homeowner's Policies of Title Insurance which establish a Deductible Amount and a Maximum Dollar Limit of Liability for certain coverages are also set forth in Exhibit A. Copies of the policy forms should be read. They are available from the office which issued this report.

Please read the exceptions shown or referred to below and the exceptions and exclusions set forth in Exhibit A of this report carefully. The exceptions and exclusions are meant to provide you with notice of matters which are not covered under the terms of the title insurance policy and should be carefully considered.

It is important to note that this preliminary report is not a written representation as to the condition of title and may not list all liens, defects, and encumbrances affecting title to the land.

This report (and any supplements or amendments hereto) is issued solely for the purpose of facilitating the issuance of a policy of title insurance and no liability is assumed hereby. If it is desired that liability be assumed prior to the issuance of a policy of title insurance, a binder or commitment should be requested.

Dated as of _____, 2_____, at 7:30 A.M.

_____
Title Officer

The form of policy of title insurance contemplated by this report is:

The estate or interest in the land hereinafter described or referred to covered by this Report is:

Title to said estate or interest at the date hereof is vested in:

The land referred to in this Report is situated in the State of California, County of _____, and is described as follows:

At the date hereof exceptions to coverage in addition to the printed Exceptions and Exclusions in said policy form would be as follows:

Exhibit A (Revised 11-17-06)

CALIFORNIA LAND TITLE ASSOCIATION
STANDARD COVERAGE POLICY – 1990

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 or zoning laws, ordinances, or regulations) restricting, regulating, prohibiting or relating (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 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) whether or not recorded in the public records at Date of Policy, but 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 insured mortgage or for the estate or interest insured by this policy.

4. Unenforceability of the lien of the insured mortgage because of the inability or failure of the insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with the applicable doing business laws of the state in which the land is situated.

5. Invalidity or unenforceability of the lien of the insured mortgage, or claim thereof, which arises out of the transaction evidenced by the insured mortgage and is based upon usury or any consumer credit protection or truth in lending law.

6. Any claim, which arises out of the transaction vesting in the insured the estate of interest insured by this policy or the transaction creating the interest of the insured lender, by reason of the operation of federal bankruptcy, state insolvency or similar creditors' rights laws.

EXCEPTIONS FROM COVERAGE - SCHEDULE B, PART I

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. Taxes or assessments which are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the public records.

   Proceedings by a public agency which may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the public records.

2. Any facts, rights, interests, or claims which are not shown by the public records but which could be ascertained by an inspection of the land or which may be asserted by persons in possession thereof.

3. Easements, liens or encumbrances, or claims thereof, which are not shown by the public records.

4. Discrepancies, conflicts in boundary lines, shortage in area, encroachments, or any other facts which a correct survey would disclose, and which are not shown by the public records.

5. (a) Unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims or title to water, whether or not the matters excepted under (a), (b) or (c) are shown by the public records.

CLTA HOMEOWNER'S POLICY OF TITLE INSURANCE (10/22/03)
ALTA HOMEOWNER'S POLICY OF TITLE INSURANCE

EXCLUSIONS

In addition to the Exceptions in Schedule B, You are not insured against loss, costs, attorneys' fees, and expenses resulting from:

1. Governmental police power, and the existence or violation of any law or government regulation. This includes ordinances, laws and regulations concerning:

   a. building
   b. zoning
   c. Land use
   d. improvements on the Land
   e. Land division
   f. environmental protection

   This Exclusion does not apply to violations or the enforcement of these matters if notice of the violation or enforcement appears in the Public Records at the Policy Date.

   This Exclusion does not limit the coverage described in Covered Risk 14, 15, 16, 17 or 24.

2. The failure of Your existing structures, or any part of them, to be constructed in accordance with applicable building codes. This Exclusion does not apply to violations of building codes if notice of the violation appears in the Public Records at the Policy Date.

3. The right to take the Land by condemning it, unless:

   a. a notice of exercising the right appears in the Public Records at the Policy Date; or
   b. the taking happened before the Policy Date and is binding on You if You bought the Land without Knowing of the taking.

4. Risks:

   a. that are created, allowed, or agreed to by You, whether or not they appear in the Public Records;
   b. that are Known to You at the Policy Date, but not to Us, unless they appear in the Public Records at the Policy Date;
   c. that result in no loss to You; or
   d. that first occur after the Policy Date - this does not limit the coverage described in Covered Risk 7, 8.d, 22, 23, 24 or 25.

5. Failure to pay value for Your Title.

6. Lack of a right:

   a. to any Land outside the area specifically described and referred to in paragraph 3 of Schedule A; and
   b. in streets, alleys, or waterways that touch the Land.

   This Exclusion does not limit the coverage described in Covered Risk 11 or 18.

LIMITATIONS ON COVERED RISKS

Your insurance for the following Covered Risks is limited on the Owner's Coverage Statement as follows:

- For Covered Risk 14, 15, 16 and 18, Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.

The deductible amounts and maximum dollar limits shown on Schedule A are as follows:

	Your Deductible Amount	Our Maximum Dollar Limit of Liability
Covered Risk 14:	____% of Policy Amount or $ _____ (whichever is less)	$ _____
Covered Risk 15:	____% of Policy Amount or $ _____ (whichever is less)	$ _____
Covered Risk 16:	____% of Policy Amount or $ _____ (whichever is less)	$ _____
Covered Risk 18:	____% of Policy Amount or $ _____ (whichever is less)	$ _____

AMERICAN LAND TITLE ASSOCIATION
RESIDENTIAL TITLE INSURANCE POLICY (6-1-87)

EXCLUSIONS

In addition to the Exceptions in Schedule B, you are not insured against loss, costs, attorneys' fees, and expenses resulting from:

1. Governmental police power, and the existence or violation of any law or government regulation. This includes building and zoning ordinances and also laws and regulations concerning:

   * land use
   * improvements on the land
   * land division
   * environmental protection

This exclusion does not apply to violations or the enforcement of these matters which appear in the public records at Policy Date.

This exclusion does not limit the zoning coverage described in Items 12 and 13 of Covered Title Risks.

2. The right to take the land by condemning it, unless:

   * a notice of exercising the right appears in the public records
   * on the Policy Date
   * the taking happened prior to the Policy Date and is binding on you if you bought the land without knowing of the taking

3. Title Risks:

   * that are created, allowed, or agreed to by you
   * that are known to you, but not to us, on the Policy Date -- unless they appeared in the public records
   * that result in no loss to you
   * that first affect your title after the Policy Date -- this does not limit the labor and material lien coverage in Item 8 of Covered Title Risks

4. Failure to pay value for your title.

5. Lack of a right:

   * to any land outside the area specifically described and referred to in Item 3 of Schedule A

   OR

   * in streets, alleys, or waterways that touch your land

This exclusion does not limit the access coverage in Item 5 of Covered Title Risks.

AMERICAN LAND TITLE ASSOCIATION LOAN POLICY (10-17-92)
WITH ALTA ENDORSEMENT-FORM 1 COVERAGE

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 (except to the extent that this policy insures the priority of the lien of the insured mortgage over any statutory lien for services, labor or material or to the extent insurance is afforded herein as to assessments for street improvements under construction or completed at 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 insured mortgage.

4. Unenforceability of the lien of the insured mortgage because of the inability or failure of the insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with applicable doing business laws of the state in which the land is situated.

5. Invalidity or unenforceability of the lien of the insured mortgage, or claim thereof, which arises out of the transaction evidenced by the insured mortgage and is based upon usury or any consumer credit protection or truth in lending law.

6. Any statutory lien for services, labor or materials (or the claim of priority of any statutory lien for services, labor or materials over the lien of the insured mortgage) arising from an improvement or work related to the land which is contracted for and commenced subsequent to Date of Policy and is not 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.

7. Any claim, which arises out of the transaction creating the interest of the mortgagee insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that is based on:

(i) the transaction creating the interest of the insured mortgagee being deemed a fraudulent conveyance or fraudulent transfer; or

(ii) the subordination of the interest of the insured mortgagee as a result of the application of the doctrine or equitable subordination; or

(iii) the transaction creating the interest of the insured mortgagee being deemed a preferential transfer except where the preferential transfer results from the failure:

(a) to timely record the instrument of transfer; or

(b) of such recordation to impart notice to a purchaser for value or a judgement or lien creditor.

The above policy forms may be issued to afford either Standard Coverage or Extended Coverage. In addition to the above Exclusions from Coverage, the Exceptions from Coverage in a Standard Coverage policy will also include the following General Exceptions:

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. Taxes or assessments which are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the public records.

Proceedings by a public agency which may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the public records.

2. Any facts, rights, interests or claims which are not shown by the public records but which could be ascertained by an inspection of the land or which may be asserted by persons in possession thereof.

3. Easements, liens or encumbrances, or claims thereof, which are not shown by the public records.

4. Discrepancies, conflicts in boundary lines, shortage in area, encroachments, or any other facts which a correct survey would disclose, and which are not shown by the public records.

5. (a) Unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims or title to water, whether or not the matters excepted under (a), (b) or (c) are shown by the public records.

2006 ALTA LOAN POLICY (06-17-06)

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 that arise by reason of:

1. (a) Any law, ordinance, permit, or governmental regulation (including those relating to building and zoning) restricting, regulating, prohibiting, or relating to

   (i) the occupancy, use, or enjoyment of the Land;
   (ii) the character, dimensions, or location of any improvement erected on the Land;
   (iii) the subdivision of land; or
   (iv) environmental protection;

   or the effect of any violation of these laws, ordinances, or governmental regulations. This Exclusion 1(a) does not modify or limit the coverage provided under Covered Risk 5.

   (b) Any governmental police power. This Exclusion 1(b) does not modify or limit the coverage provided under Covered Risk 6.

2. Rights of eminent domain. This Exclusion does not modify or limit the coverage provided under Covered Risk 7 or 8.

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 (however, this does not modify or limit the coverage provided under Covered Risk 11, 13, or 14); or
   (e) resulting in loss or damage that would not have been sustained if the Insured Claimant had paid value for the Insured Mortgage.

4. Unenforceability of the lien of the Insured Mortgage because of the inability or failure of an Insured to comply with applicable doing-business laws of the state where the Land is situated.

5. Invalidity or unenforceability in whole or in part of the lien of the Insured Mortgage that arises out of the transaction evidenced by the Insured Mortgage and is based upon usury or any consumer credit protection or truth-in-lending law.

6. Any claim, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that the transaction creating the lien of the Insured Mortgage, is

(a) a fraudulent conveyance or fraudulent transfer, or
(b) a preferential transfer for any reason not stated in Covered Risk 13(b) of this policy.

7. Any lien on the Title for real estate taxes or assessments imposed by governmental authority and created or attaching between Date of Policy and the date of recording of the Insured Mortgage in the Public Records. This Exclusion does not modify or limit the coverage provided under Covered Risk 11(b).

AMERICAN LAND TITLE ASSOCIATION OWNER'S POLICY (10-17-92)

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:

   (i) the transaction creating the estate or interest insured by this policy being deemed a fraudulent conveyance or fraudulent transfer; or

   (ii) 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:

(a) to timely record the instrument of transfer; or

(b) of such recordation to impart notice to a purchaser for value or a judgement or lien creditor.

The above policy forms may be issued to afford either Standard Coverage or Extended Coverage. In addition to the above Exclusions from Coverage, the Exceptions from Coverage in a Standard Coverage Policy will also include the following General Exceptions:

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. Taxes or assessments which are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the public records.

   Proceedings by a public agency which may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the public records.

2. Any facts, rights, interests or claims which are not shown by the public records but which could be ascertained by an inspection of the land or which may be asserted by persons in possession thereof.

3. Easements, liens or encumbrances, or claims thereof, which are not shown by the public records.

4. Discrepancies, conflicts in boundary lines, shortage in area, encroachments, or any other facts which a correct survey would disclose, and which are not shown by the public records.

5. (a) Unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims or title to water, whether or not the matters excepted under (a), (b) or (c) are shown by the public records.

2006 ALTA OWNER'S POLICY (06-17-06)

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 that arise by reason of:

1. (a) Any law, ordinance, permit, or governmental regulation (including those relating to building and zoning) restricting, regulating, prohibiting, or relating to

   (i) the occupancy, use, or enjoyment of the Land;

   (ii) the character, dimensions, or location of any improvement erected on the Land;

   (iii) the subdivision of land; or

   (iv) environmental protection;

   or the effect of any violation of these laws, ordinances, or governmental regulations. This Exclusion 1(a) does not modify or limit the coverage provided under Covered Risk 5.

   (b) Any governmental police power. This Exclusion 1(b) does not modify or limit the coverage provided under Covered Risk 6.

2. Rights of eminent domain. This Exclusion does not modify or limit the coverage provided under Covered Risk 7 or 8.

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 (however, this does not modify or limit the coverage provided under Covered Risk 9 and 10); or

   (e) resulting in loss or damage that would not have been sustained if the Insured Claimant had paid value for the Title.

4. Any claim, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that the transaction vesting the Title as shown in Schedule A, is

   (a) a fraudulent conveyance or fraudulent transfer; or

   (b) a preferential transfer for any reason not stated in Covered Risk 9 of this policy.

5. Any lien on the Title for real estate taxes or assessments imposed by governmental authority and created or attaching between Date of Policy and the date of recording of the deed or other instrument of transfer in the Public Records that vests Title as shown in Schedule A.

ALTA EXPANDED COVERAGE RESIDENTIAL LOAN POLICY (10/13/01)

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 areas 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 s 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. This exclusion does not limit the coverage provided under Covered Risks 12, 13, 14, and 16 of this 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. This exclusion does not limit the coverage provided under Covered Risks 12, 13, 14, and 16 of this 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 (this paragraph does not limit the coverage provided under Covered Risks 8, 16, 18, 19, 20, 21, 22, 23, 24, 25 and 26); or

(e) resulting in loss or damage which would not have been sustained if the Insured Claimant had paid value for the Insured Mortgage.

4. Unenforceability of the lien of the Insured Mortgage because of the inability or failure of the Insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with applicable doing business laws of the state in which the Land is situated.

5. Invalidity or unenforceability of the lien of the Insured Mortgage, or claim thereof, which arises out of the transaction evidenced by the Insured Mortgage and is based upon usury, except as provided in Covered Risk 27, or any consumer credit protection or truth in lending law.

6. Real property taxes or assessments of any governmental authority which become a lien on the Land subsequent to Date of Policy. This exclusion does not limit the coverage provided under Covered Risks 7, 8(e) and 26.

7. Any claim of invalidity, unenforceability or lack of priority of the lien of the Insured Mortgage as to advances or modifications made after the Insured has Knowledge that the vestee shown in Schedule A is no longer the owner of the estate or interest covered by this policy. This exclusion does not limit the coverage provided in Covered Risk 8.

8. Lack of priority of the lien of the Insured Mortgage as to each and every advance made after Date of Policy, and all interest charged thereon, over liens, encumbrances and other matters affecting the title, the existence of which are Known to the Insured at:

(a) The time of the advance; or

(b) The time a modification is made to the terms of the Insured Mortgage which changes the rate of interest charged, if the rate of Interest is greater as a result of the modification than it would have been before the modification. This exclusion does not limit the coverage provided in Covered Risk 8.

9. The failure of the residential structure, or any portion thereof to have been constructed before, on or after Date of Policy in accordance with applicable building codes. This exclusion does not apply to violations of building codes if notice of the violation appears in the Public Records at Date of Policy.

4. Unenforceability of the lien of the Insured Mortgage because of the inability or failure of the Insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with applicable doing business laws of the state in which the Land is situated.

5. Invalidity or unenforceability of the lien of the Insured Mortgage, or claim thereof, which arises out of the transaction evidenced by the Insured Mortgage and is based upon usury, except as provided in Covered Risk 27, or any consumer credit protection or truth in lending law.

6. Real property taxes or assessments of any governmental authority which become a lien on the Land subsequent to Date of Policy. This exclusion does not limit the coverage provided under Covered Risks 7, 8(e) and 26.

7. Any claim of invalidity, unenforceability or lack of priority of the lien of the Insured Mortgage as to advances or modifications made after the Insured has Knowledge that the vestee shown in Schedule A is no longer the owner of the estate or interest covered by this policy. This exclusion does not limit the coverage provided in Covered Risk 8.

8. Lack of priority of the lien of the Insured Mortgage as to each and every advance made after Date of Policy, and all interest charged thereon, over liens, encumbrances and other matters affecting the title, the existence of which are Known to the Insured at:

   (a) The time of the advance; or

   (b) The time a modification is made to the terms of the Insured Mortgage which changes the rate of interest charged, if the rate of interest is greater as a result of the modification than it would have been before the modification. This exclusion does not limit the coverage provided in Covered Risk 8.

9. The failure of the residential structure, or any portion thereof to have been constructed before, on or after Date of Policy in accordance with applicable building codes. This exclusion does not apply to violations of building codes if notice of the violation appears in the Public Records at Date of Policy.

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Appendix F

ALTA Commitment Form (1982)

INFORMATION

The Title Insurance Commitment is a legal contract between you and the Company. It is issued to show the basis on which we will issue a Title Insurance Policy to you. The Policy will insure you against certain risks to the land title, subject to the limitations shown in the Policy.

The Company will give you a sample of the Policy form, if you ask.

The Commitment is based on the land title as of the Commitment Date. Any changes in the land title or the transaction may affect the Commitment and the Policy.

The Commitment is subject to its Requirements, Exceptions and Conditions.

THIS INFORMATION IS NOT PART OF THE TITLE INSURANCE COMMITMENT. YOU SHOULD READ THE COMMITMENT VERY CAREFULLY.

If you have any questions about the Commitment, contact .

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2. Policies to be Issued, Amounts and Proposed Insureds
3. Interest in the Land and Owner
4. Description of the land
SCHEDULE B-I-REQUIREMENTS
SCHEDULE B-II-EXCEPTIONS
CONDITIONS

TITLE INSURANCE COMMITMENT
BY
BLANK TITLE INSURANCE COMPANY

AGREEMENT TO ISSUE POLICY

We agree to issue policy to you according to the terms of the Commitment. When we show the policy amount and your name as the proposed insured in Schedule A, this Commitment becomes effective as of the Commitment Date shown in Schedule A.

If the Requirements shown in this Commitment have not been met within

(Instructions to ALTA members: this period is optional with the Company) after the Commitment Date, our obligation under this Commitment will end. Also, our obligation under this Commitment will end when the Policy is issued and then our obligation to you will be under the Policy.

Our obligation under this Commitment is limited by the following:

The Provisions in Schedule A.

The Requirements in Schedule B-I.

The Exceptions in Schedule B-II.

The Conditions on Page .

This Commitment is not valid without SCHEDULE A and Sections I and II of SCHEDULE B.

(Instructions to ALTA Members: The countersignature clause is optional with each Company.)

SCHEDULE A

1. Commitment Date:
2. Policy (or Policies) to be issued:

(Instructions to ALTA Members: The Company should identify forms of policies below)

(a) Owner's Policy Policy Amount $
Proposed Insured:

(b) Loan Policy Policy Amount $
Proposed Insured:

(c) Policy Amount $
Proposed Insured:

3. _____ interest in the land described in this Commitment is owned, at the Commitment Date, by _____.
4. The land referred to in the Commitment is described as follows:

(Instructions to ALTA Members: At the option of the Company, Item 4 may read: The land referred to in this Commitment is described in

Schedule C.)

SCHEDULE B-SECTION I

REQUIREMENTS

The following requirements must be met:

(a) Pay the agreed amounts for the interest in the land and/or the mortgage to be insured.

(b) Pay us the premiums, fees and charges for the policy.

(c) Documents satisfactory to us creating the interest in the land and/or the mortgage to be insured must be signed, delivered and recorded.

(Instructions to ALTA Members: A period may be added to the above or a colon may be added and specific documents typed in.)

(d) You must tell us in writing the name of anyone not referred to in this Commitment who will get an interest in the land or who will make a loan on the land. We may then make additional requirements or exceptions.

(Instructions to ALTA Members: Additional requirements may be listed here.)

SCHEDULE B-SECTION II

EXCEPTIONS

Any policy we issue will have the following exceptions unless they are taken care of to our satisfaction.

CONDITIONS

1. DEFINITIONS

(a) "Mortgage" means mortgage, deed of trust or other security instrument. (b) "Public Records" means title records that give constructive notice of matters affecting your title — according to the state statutes where your land is located.

2. LATER DEFECTS

The Exceptions in Schedule B-Section II may be amended to show any defects, liens or encumbrances that appear for the first time in the public records or are created or attach between the Commitment Date and the date on which all of the Requirements (a) and (c) of Schedule B-Section I are met. We shall have no liability to you because of this amendment.

3. EXISTING DEFECTS

If any defects, liens or encumbrances existing at Commitment Date are not shown in Schedule B, we may amend Schedule B to show them. If we do amend Schedule B to show these defects, liens or encumbrances, we shall be liable to you according to Paragraph 4 below unless you knew of this information and did not tell us about it in writing.

4. LIMITATION OF OUR LIABILITY

Our only obligation is to issue to you the Policy referred to in this Commitment, when you have met its Requirements. If we have any liability to you for any loss you incur because of an error in this Commitment, our liability will be limited to your actual loss caused by your relying on this Commitment when you acted in good faith to:

Comply with the Requirements shown in Schedule B-Section I

or

Eliminate with our written consent any Exceptions shown in Schedule B-Section II.

We shall not be liable for more than the Policy Amount shown in Schedule A of this Commitment and our liability is subject to the terms of the Policy form to be issued to you.

5. CLAIMS MUST BE BASED ON THIS COMMITMENT

Any claim, whether or not based on negligence, which you may have against us concerning the title to the land must be based on this Commitment and is subject to its terms.

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Appendix G

ALTA Commitment Form (2006)



ALTA Commitment Form

COMMITMENT FOR TITLE INSURANCE

Issued by

Blank Title Insurance Company

Blank Title Insurance Company, a _____ corporation ("Company"), for a valuable consideration, commits to issue its policy or policies of title insurance, as identified in Schedule A, in favor of the Proposed Insured named in Schedule A, as owner or mortgagee of the estate or interest in the land described or referred to in Schedule A, upon payment of the premiums and charges and compliance with the Requirements; all subject to the provisions of Schedules A and B and to the Conditions of this Commitment.

This Commitment shall be effective only when the identity of the Proposed Insured and the amount of the policy or policies committed for have been inserted in Schedule A by the Company.

All liability and obligation under this Commitment shall cease and terminate _____ (here state the time period)* after the Effective Date or when the policy or policies committed for shall issue, whichever first occurs, provided that the failure to issue the policy or policies is not the fault of the Company.

The Company will provide a sample of the policy form upon request.

IN WITNESS WHEREOF, Blank Title Insurance Company has caused its corporate name and seal to be affixed by its duly authorized officers on the date shown in Schedule A.**

BLANK TITLE INSURANCE COMPANY

BY:_____

PRESIDENT

Attest:_____

SECRETARY

Note:

*The time to be stated is optional with the company and should conform to local usage.

**If the Commitment is to be executed by a validating officer, then prior to the "In Witness Whereof" there should be inserted: "This Commitment shall not be valid or binding until countersigned by a validating officer or authorized signatory." the manner of execution will conform to the company's practice and will of necessity require some modification in the language identifying the manner of execution. This is deemed a matter of format.

SCHEDULE A

1. Effective Date:
2. Policy or Policies to be issued: Amount
   a. _____ Owner's Policy (Identify form used): $_____

      Proposed Insured:

   b. _____ Loan Policy (Identify form used): $_____

      Proposed Insured:

   (Note: The Company, in printing, should set forth and identify the form or forms of policies of title insurance to be used. If Commitment is printed showing more than one type of policy, the amount of the policy or policies should be completed and the box checked as to all forms proposed to be issued. The manner of setting up and identifying the policy or policies to be issued is a matter of format.)

3. The estate or interest in the land described or referred to in this Commitment is _____

   (Identify estate covered, i.e. Fee, Leasehold, etc.)

4. Title to the _____ estate or interest in the land is at the Effective Date vested in:

5. The land referred to in this Commitment is described as follows:

*Items 3 and 4 may be combined or item 3 eliminated completely in instances where the estate to be covered has already been created and is the same as the estate reported on as of the Effective Date of the Commitment. If, however, the estate to be covered is less than a fee and has not yet been created and the estate reported on at the Effective Date of the Commitment is the fee, then it would be more appropriate to set forth both items 3 and 4 in the language suggested or in appropriate language, these being matters of format rather than substance.

SCHEDULE B*

1. Requirements:

   (Note: Appropriate language should be inserted to set forth the requirements of the Company. In many areas, a subcaption may be used such as: "Instruments in insurable form which must be executed, delivered, and duly filed for record:")

2. Schedule B of the policy or policies to be issued will contain exceptions to the following matters unless the same are disposed of to the satisfaction of the Company:

   Defects, liens, encumbrances, adverse claims or other matters, if any, created, first appearing in the public records or attaching subsequent to the Effective Date but prior to the date the proposed Insured acquires for value of record the estate or interest or mortgage thereon covered by this Commitment.

Note: There should be set forth in paragraph numbered II of Schedule B all matters that would be shown in Schedule B of an Owner's Policy issued on the effective date of the Commitment, including those general exceptions such as rights of parties in possession, survey matters, etc., which in many instances are printed as part of Schedule B of the Policy. It is proper to note that an exception shown may be omitted from the Policy as outside of the coverage of the Policy to be issued, or for some other reason.

* In areas where it is not the custom for title companies to state requirements for insurance, the Commitment would be printed without paragraph numbered I of Schedule B and only paragraph numbered II would be shown as a caption for Schedule B.

CONDITIONS

1. The term mortgage, when used herein, shall include deed of trust, trust deed, or other security instrument.
2. If the proposed Insured has or acquired actual knowledge of any defect, lien, encumbrance, adverse claim or other matter affecting the estate or interest or mortgage thereon covered by this Commitment other than those shown in Schedule B hereof, 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. If the proposed Insured shall disclose such knowledge to the Company, or if the Company otherwise acquires actual knowledge of any such defect, lien, encumbrance, adverse claim or other matter, the Company at its option may amend Schedule B of this Commitment accordingly, but such amendment shall not relieve the Company from liability previously incurred pursuant to paragraph 3 of these Conditions.

3. Liability of the Company under this Commitment shall be only to the named proposed Insured and such parties included under the definition of Insured in the form of policy or policies committed for and only for actual loss incurred in reliance hereon in undertaking in good faith (a) to comply with the requirements hereof, or (b) to eliminate exceptions shown in Schedule B, or (c) to acquire or create the estate or interest or mortgage thereon covered by this Commitment. In no event shall such liability exceed the amount stated in Schedule A for the policy or policies committed for and such liability is subject to the insuring provisions and Conditions and the Exclusions from Coverage of the form of policy or policies committed for in favor of the proposed Insured which are hereby incorporated by reference and are made a part of this Commitment except as expressly modified herein.
4. This Commitment is a contract to issue one or more title insurance policies and is not an abstract of title or a report of the condition of title. Any action or actions or rights of action that the proposed Insured may have or may bring against the Company arising out of the status of the title to the estate or interest or the status of the mortgage thereon covered by this Commitment must be based on and are subject to the provisions of this Commitment.
5. *The policy to be issued contains an arbitration clause. All arbitrable matters when the Amount of Insurance is $2,000,000 or less shall be arbitrated at the option of either the Company or the Insured as the exclusive remedy of the parties. You may review a copy of the arbitration rules at< http://www.alta.org/>.*

ALTA Plain Language Commitment Form

INFORMATION

The Title Insurance Commitment is a legal contract between you and the Company. It is issued to show the basis on which we will issue a Title Insurance Policy to you. The Policy will insure you against certain risks to the land title, subject to the limitations shown in the Policy.

The Company will give you a sample of the Policy form, if you ask.

The Policy contains an arbitration clause. All arbitrable matters when the Amount of Insurance is $2,000,000 or less shall be arbitrated at the option of either the Company or you as the exclusive remedy of the parties. You may review a copy of the arbitration rules at <http://www.alta.org/>.

The Commitment is based on the land title as of the Commitment Date. Any changes in the land title or the transaction may affect the Commitment and the Policy.

The Commitment is subject to its Requirements, Exceptions and Conditions.

THIS INFORMATION IS NOT PART OF THE TITLE INSURANCE COMMITMENT. YOU SHOULD READ THE COMMITMENT VERY CAREFULLY.

If you have any questions about the Commitment, contact _____

_____.

Print

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3. Interest in the Land and Owner
4. Description of the Land

SCHEDULE B-I -- REQUIREMENTS

SCHEDULE B-II -- EXCEPTIONS

CONDITIONS

Print

TITLE INSURANCE COMMITMENT

BY

Blank Title Insurance Company

AGREEMENT TO ISSUE POLICY

We agree to issue policy to you according to the terms of the Commitment. When we show the policy amount and your name as the proposed insured in Schedule A, this Commitment becomes effective as of the Commitment Date shown in Schedule A.

If the Requirements shown in this Commitment have not been met within _____ insert time period _____ after the Commitment Date, our obligation under this Commitment will end. Also, our obligation under this Commitment will end when the Policy is issued and then our obligation to you will be under the Policy.

Our obligation under this Commitment is limited by the following:

The Provisions in Schedule A.

The Requirements in Schedule B-I.

The Exceptions in Schedule B-II.

The Conditions on Page _____.

This Commitment is not valid without SCHEDULE A and Sections I and II of SCHEDULE B.

(The countersignature clause is optional.)

SCHEDULE A

1. Commitment Date:
2. Policy (or Policies) to be issued:
    a. Owner's Policy Policy Amount $_____

        Proposed Insured:

    b. Loan Policy Policy Amount $_____

        Proposed Insured:

    c. Proposed Insured: Policy Amount $_____

3. _____ interest in the land described in this Commitment is owned, at the Commitment Date, by _____.
4. The land referred to in the Commitment is described as follows:

SCHEDULE B - SECTION I

REQUIREMENTS

The following requirements must be met:

a. Pay the agreed amounts for the interest in the land and/or the mortgage to be insured.
b. Pay us the premiums, fees and charges for the policy.
c. Documents satisfactory to us creating the interest in the land and/or the mortgage to be insured must be signed, delivered and recorded.

(A period may be added to the above or a colon may be added and specific documents typed in.)

d. You must tell us in writing the name of anyone not referred to in this Commitment who will get an interest in the land or who will make a loan on the land. We may then make additional requirements or exceptions.

(Additional requirements may be listed here.)

SCHEDULE B - SECTION II

EXCEPTIONS

Any policy we issue will have the following exceptions unless they are taken care of to our satisfaction.

CONDITIONS

1. DEFINITIONS

(a) "Mortgage" means mortgage, deed of trust or other security instrument. (b) "Public Records" means title records that give constructive notice of matters affecting your title according to the state statutes where your land is located.

2. LATER DEFECTS

The Exceptions in Schedule B - Section II may be amended to show any defects, liens or encumbrances that appear for the first time in the public records or are created or attach between the Commitment Date and the date on which all of the Requirements (a) and (c)

of Schedule B - Section I are met. We shall have no liability to you because of this amendment.

3. EXISTING DEFECTS

If any defects, liens or encumbrances existing at Commitment Date are not shown in Schedule B, we may amend Schedule B to show them. If we do amend Schedule B to show these defects, liens or encumbrances, we shall be liable to you according to Paragraph 4 below unless you knew of this information and did not tell us about it in writing.

4. LIMITATION OF OUR LIABILITY

Our only obligation is to issue to you the Policy referred to in this Commitment, when you have met its Requirements. If we have any liability to you for any loss you incur because of an error in this Commitment, our liability will be limited to your actual loss caused by your relying on this Commitment when you acted in good faith to:

Comply with the Requirements shown in Schedule B - Section I

or

Eliminate with our written consent any Exceptions shown in Schedule B - Section II.

We shall not be liable for more than the Policy Amount shown in Schedule A of this Commitment and our liability is subject to the terms of the Policy form to be issued to you.

5. CLAIMS MUST BE BASED ON THIS COMMITMENT

Any claim, whether or not based on negligence, which you may have against us concerning the title to the land must be based on this Commitment and is subject to its terms.

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Appendix H

CLTA Standard Coverage Policy (1990)

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 right of access to and from the land;

and in addition, as to an insured lender only:

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, said mortgage being shown in Schedule B in the order of its priority;
7. The invalidity or unenforceability of any assignment of the insured mortgage, provided the assignment is shown in Schedule B, or the failure of the assignment shown in Schedule B 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 or the lien of the insured mortgage, 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 are expenses which arise by reason of:

1. (a) Any law, ordinance or governmental regulations (including but not limited to building or 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) whether or not recorded in the public records at Date of Policy, but 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 insured mortgage or for the estate or interest insured by this policy.
4. Unenforceability of the lien of the insured mortgage because of the inability or failure of the insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with the applicable doing business laws of the state in which the land is situated.

5. Invalidity or unenforceability of the lien of the insured mortgage, or claim thereof, which arises out of the transaction evidenced by the insured mortgage and is based upon usury or any consumer credit protection or truth in lending law.
6. Any claim, which arises out of the transaction vesting in the insured the estate or interest insured by this policy or the transaction creating the interest of the insured lender, by reason of the operation of federal bankruptcy, state insolvency or similar creditors' rights laws.

SCHEDULE A

(File No.) Policy No.
Amount of Insurance $
Premium $

Date of Policy _____ (at a.m. or 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:

PART I

1. Taxes or assessments which are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the public records.

   Proceedings by a public agency which may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the public records.
2. Any facts, rights, interests or claims which are not shown by the public records but which could be ascertained by an inspection of the land or which may be asserted by persons in possession thereof.
3. Easements, liens or encumbrances, or claims thereof, which are not shown by the public records.
4. Discrepancies, conflicts in boundary lines, shortage in area, encroachments, or any other facts which a correct survey would disclose, and which are not shown by the public records.
5. (a) Unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims or title to water, whether or not the matters excepted under (a), (b) or (c) are shown by the public records.

PART II

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. The term "insured" also includes:

(i) the owner of the indebtedness secured by the insured mortgage and each successor in ownership of the indebtedness except a successor who is an obligor under the provisions of Section 12(c) of these Conditions and Stipulations (reserving, however, all rights and defenses as to any successor that the Company would have had against any predecessor insured, unless the successor acquired the indebtedness as a purchaser for value without knowledge of the asserted defect, lien, encumbrance, adverse claim or other matter insured against by this policy as affecting title to the estate or interest in the land);

(ii) any governmental agency or governmental instrumentality which is an insurer or guarantor under an insurance contract or guaranty insuring or guaranteeing the indebtedness secured by the insured mortgage, or any part thereof, whether named as an insured herein or not;

(iii) the parties designated in Section 2(a) of these Conditions and Stipulations.

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

(c) "insured lender": the owner of an insured mortgage.

(d) "insured mortgage": a mortgage shown in Schedule B, the owner of which is named as an insured in Schedule A.

(e) "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.

(f) "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.

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

(h) "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.

(i) "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 or the insured mortgage to be released from the obligation to purchase by virtue of a contractual condition requiring the delivery of marketable title.

2. Continuation of Insurance

(a) After Acquisition of Title by Insured Lender. If this policy insures the owner of the indebtedness secured by the insured mortgage, the coverage of this policy shall continue in force as of Date of Policy in favor of (i) such insured lender who acquires all or any part of the estate or interest in the land by foreclosure, trustee's sale, conveyance in lieu of foreclosure, or other legal manner which discharges the lien of the insured mortgage; (ii) a transferee of the estate or interest so acquired from an insured corporation, provided the transferee is the parent or wholly-owned subsidiary of the insured corporation, and their corporate successors by operation of law and not by purchase, subject to any rights or defenses the Company may have against any predecessor insureds; and (iii) any governmental agency or governmental instrumentality which acquires all or any part of the estate or interest pursuant to a contract of insurance or guaranty insuring or guaranteeing the indebtedness secured by the insured mortgage.

(b) After Conveyance of Title by an Insured. 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 an insured of either (i) an estate or interest in the land, or (ii) an indebtedness secured by a purchase money mortgage given to an insured.

(c) Amount of Insurance. The amount of insurance after the acquisition or after the conveyance by an insured lender shall in neither event exceed the least of:

(i) The amount of insurance stated in Schedule A;

(ii) The amount of the principal of the indebtedness secured by the insured mortgage as of Date of Policy, interest thereon, expenses of foreclosure, amounts advanced pursuant to the insured mortgage to assure compliance with laws or to protect the lien of the insured mortgage prior to the time of acquisition of the estate or interest in the land and secured thereby and reasonable amounts expended to prevent deterioration of improvements, but reduced by the amount of all payments made; or

(iii) The amount paid by an governmental agency or governmental instrumentality, if the agency or the instrumentality is the insured claimant, in the acquisition of the estate or interest in satisfaction of its insurance contract or guaranty.

3. Notice of Claim to be Given by Insured Claimant.

An insured shall notify the Company promptly in writing (i) in case of any litigation as set forth in 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 or the lien of the insured mortgage, 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 or the lien of the insured mortgage, as insured, is rejected as unmarketable. If prompt notice shall not be given to the Company, then as to that 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 an 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 such 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 such 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 an 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 or the lien of the insured mortgage, as insured, or to prevent or reduce loss or damage to an 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, an 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 such insured for this purpose. Whenever requested by the Company, an 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 or the lien of the insured mortgage, as insured. If the Company is prejudiced by the failure of an insured to furnish the required cooperation, the Company's obligations to such 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 each 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 an insured claimant to provide the required proof of loss or damage, the Company's obligations to such 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, an 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 an 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 an 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, unless prohibited by law or governmental regulation, shall terminate any liability of the Company under this policy as to that insured for 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 or to Purchase the Indebtedness.

(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; or

(ii) in case loss or damage is claimed under this policy by the owner of the indebtedness secured by the insured mortgage, to purchase the indebtedness secured by the insured mortgage for the amount owning thereon together with any costs, attorneys' fees and expenses incurred by the insured claimant which were authorized by the Company up to the time of purchase and which the Company is obligated to pay.

If the Company offers to purchase the indebtedness as herein provided, the owner of the indebtedness shall transfer, assign, and convey the indebtedness and the insured mortgage, together with any collateral security, to the Company upon payment therefor.

Upon the exercise by the Company of the option provided for in paragraph a(i), all liability and obligations to the insured under this policy, other than to make the payment required in that paragraph, 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.

Upon the exercise by the Company of the option provided for in paragraph a(ii) the Company's obligation to an insured Lender under this policy for the claimed loss or damage, other than the payment required to be made, shall terminate, including any liability or obligation to defend, prosecute or continue any litigation.

(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 b(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 and Extent of Liability.

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 to an insured lender shall not exceed the least of:

(i) the Amount of Insurance stated in Schedule A, or, if applicable, the amount of insurance as defined in Section 2 (c) of these Conditions and Stipulations;

(ii) the amount of the unpaid principal indebtedness secured by the insured mortgage as limited or provided under Section 8 of these Conditions and Stipulations or as reduced under Section 9 of theses Conditions and Stipulations, at the time the loss or damage insured against by this policy occurs, together with interest thereon; or

(iii) 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 insured lender has acquired the estate or interest in the manner described in Section 2(a) of these Conditions and Stipulations or has conveyed the title, then the liability of the Company shall continue as set forth in Section 7(a) of these Conditions and Stipulations.

(c) The liability of the Company under this policy to an insured owner of the estate or interest in the land described in Schedule A 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.

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

8. 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, or otherwise establishes the lien of the insured mortgage, 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, or, if applicable, to the lien of the insured mortgage, 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.

(d) The Company shall not be liable to an insured lender for: (i) any indebtedness created subsequent to Date of Policy except for advances made to protect the lien of the insured mortgage and secured thereby and reasonable amounts expended to prevent deterioration of improvements; or (ii) construction loan advances made subsequent to Date of Policy, except construction loan advances made subsequent to Date of Policy for the purpose of financing in whole or in part the construction of an improvement to the land which at Date of Policy were secured by the insured mortgage and which the insured was and continued to be obligated to advance at and after Date of Policy.

9. Reduction of Insurance; Reduction or Termination of Liability.

(a) All payments under this policy, except payments made for costs, attorneys' fees and expenses, shall reduce the amount of insurance pro tanto. However, as to an insured lender, any payments made prior to the acquisition of title to the estate or interest as provided in Section 2(a) of these Conditions and Stipulations shall not reduce pro tanto the amount of insurance afforded under this policy as to any such insured, except to the extent that the payments reduce the amount of the indebtedness secured by the insured mortgage.

(b) Payment in part by any person of the principal of the indebtedness, or any other obligation secured by the insured mortgage, or any voluntary partial satisfaction or release of the insured mortgage, to the extent of the payment, satisfaction or release, shall reduce the amount of insurance pro tanto. The amount of insurance may thereafter be increased by accruing interest and advances made to protect the lien of the insured mortgage and secured thereby, with interest thereon, provided in no event shall the amount of insurance be greater than the Amount of Insurance stated in Schedule A.

(c) Payment in full by any person or the voluntary satisfaction or release of the insured mortgage shall terminate all liability of the Company to an insured lender except as provided in Section 2(a) of these Conditions and Stipulations.

10. 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.

The provisions of this Section shall not apply to an insured lender, unless such insured acquires title to said estate or interest in satisfaction of the indebtedness secured by an insured mortgage.

11. 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.

12. 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 (i) as to an insured owner, to all rights and remedies in the proportion which the Company's payment bears to the whole amount of the loss; and (ii) as to an insured lender, to all rights and remedies of the insured claimant after the insured claimant shall have recovered its principal, interest, and costs of collection.

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 Insured's Rights and Limitations.

Notwithstanding the foregoing, the owner of the indebtedness secured by an insured mortgage, provided the priority of the lien of the insured mortgage or its enforceability is not affected, may release or substitute the personal liability of any debtor or guarantor, or extend or otherwise modify the terms of payment, or release a portion of the estate or interest from the lien of the insured mortgage, or release any collateral security for the indebtedness.

When the permitted acts of the insured claimant occur and the insured has knowledge of any claim of title or interest adverse to the title to the estate or interest or the priority or enforceability of the lien of an insured mortgage, as insured, the Company 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.

(c) 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.

The Company's right of subrogation shall not be avoided by acquisition of an insured mortgage by an obligor (except an obligor described in Section 1(a)(ii) of these Conditions and Stipulations) who acquires the insured mortgage as a result of an indemnity, guarantee, other policy of insurance, or bond and the obligor will not be an insured under this policy, notwithstanding Section 1(a)(i) of these Conditions and Stipulations.

13. 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.

14. 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 lien of the insured mortgage or 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.

15. 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.

16. 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).

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Appendix I

ALTA Loan Policy (1992)

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;
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. Any assessments for street improvements under construction or completed at Date of Policy which now have gained or hereafter may gain priority over the lien of the insured mortgage;
9. 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 or the lien of the insured mortgage, 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 regulations (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 (except to the extent that this policy insures the priority of the lien of the insured mortgage over any statutory lien for services, labor or material or to the extent insurance is afforded herein as to assessments for street improvements under construction or completed at 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 insured mortgage.

4. Unenforceability of the lien of the insured mortgage because of the inability or failure of the insured at Date of Policy, or the inability or failure of any subsequent owner of the indebtedness, to comply with applicable doing business laws of the state in which the land is situated.

5. Invalidity or unenforceability of the lien of the insured mortgage, or claim thereof, which arises out of the transaction evidenced by the insured mortgage and is based upon usury or any consumer credit protection or truth in lending law.

6. Any statutory lien for services, labor or materials (or the claim of priority of any statutory lien for services, labor or materials over the lien of the insured mortgage) arising from an improvement or work related to the land which is contracted for and commenced subsequent to Date of Policy and is not 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.

7. Any claim, which arises out of the transaction creating the interest of the mortgagee insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that is based on:

(i) the transaction creating the interest of the insured mortgagee being deemed a fraudulent conveyance or fraudulent transfer; or

(ii) the subordination of the interest of the insured mortgagee as a result of the application of the doctrine or equitable subordination; or

(iii) the transaction creating the interest of the insured mortgagee being deemed a preferential transfer except where the preferential transfer results from the failure:

(a) to timely record the instrument of transfer; or

(b) 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 $

Date of Policy _____ (at a.m. or p.m.)

1. Name of Insured:
2. The estate or interest in the land which is encumbered by the insured mortgage is:
3. Title to the estate or interest in the land is vested in:
4. The insured mortgage and assignments thereof, if any, are described as follows:

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

If Paragraph 5 is omitted, a Schedule C, captioned the same as Paragraph 5, 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:

PART I

[POLICY MAY INCLUDE THE FOLLOWING GENERAL EXCEPTIONS IF SO DESIRED BY ISSUING COMPANY:

1. Taxes or assessments which are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the public records.

   Proceedings by a public agency which may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the public records.

2. Any facts, rights, interests or claims which are not shown by the public records but which could be ascertained by an inspection of the land or by making inquiry of persons in possession thereof.
3. Easements, liens or encumbrances, or claims thereof, which are not shown by the public records.
4. Discrepancies, conflicts in boundary lines, shortage in area, encroachments, or any other facts which a correct survey would disclose, and which are not shown by the public records.
5. (a) Unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims or title to water, whether or not the matters excepted under (a), (b) or (c) are shown by the public records.]

[VARIABLE EXCEPTIONS SUCH AS TAXES, EASEMENTS, CC&Rs, ETC.]

Note: If there are matters which affect the title to the estate or interest in the land described in Schedule [A] [C], but which are subordinate to the lien of the insured mortgage, Part II of Schedule B must be added, or Part I of Schedule B must contain the following statement:

"Matters which affect the title to the estate or interest, but which or subordinate to the lien of the insured mortgage"

PART II

In addition to the matters set forth in Part I of this Schedule, the title to the estate or interest in the land described or referred to in Schedule [A] [C] is subject to the following matters, if any be shown, but the Company insures that these matters are subordinate to the lien or charge of the insured mortgage upon the estate or interest:

CONDITIONS AND STIPULATIONS

1. DEFINITION OF TERMS.

The following terms when used in this policy mean:

(a) "insured": the insured named in Schedule A. The term "insured" also includes

(i) the owner of the indebtedness secured by the insured mortgage and each successor in ownership of the indebtedness except a successor who is an obligor under the provisions of Section 12(c) of these Conditions and Stipulations (reserving, however, all rights and defenses as to any successor that the Company would have had against any predecessor insured, unless the successor acquired the indebtedness as a purchaser for value without knowledge of the asserted defect, lien, encumbrance, adverse claim or other mater insured against by this policy as affecting title to the estate or interest in the land);

(ii) any governmental agency or governmental instrumentality which is an insurer or guarantor under an insurance contract or guaranty insuring or guaranteeing the indebtedness secured by the insured mortgage, or any part thereof, whether named as an insured herein or not;

(iii) the parties designated in Section 2(a) of these Conditions and Stipulations.

(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 or the insured mortgage to be released from the obligation to purchase by virtue of a contractual condition requiring the delivery of marketable title.

2. CONTINUATION OF INSURANCE.

(a) After Acquisition of Title. The coverage of this policy shall continue in force as of Date of Policy in favor of (i) an insured who acquires all or any part of the estate or interest in the land by foreclosure, trustee's sale, conveyance in lieu of foreclosure, or other legal manner which discharges the lien of the insured mortgage; (ii) a transferee of the estate or interest so acquired from an insured corporation, provided the transferee is the parent or wholly-owned subsidiary of the insured corporation, and their corporate successors by operation of law and not by purchase, subject to any rights or defenses the Company may have against any predecessor insureds; and (iii) any governmental agency or governmental instrumentality which acquires all or any part of the estate or interest pursuant to a contract of insurance or guaranty insuring or guaranteeing the indebtedness secured by the insured mortgage.

(b) 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.

(c) Amount of Insurance: The amount of insurance after the acquisition or after the conveyance shall in neither event exceed the least of:

(i) the Amount of Insurance stated in Schedule A;

(ii) the amount of the principal of the indebtedness secured by the insured mortgage as of Date of Policy, interest thereon, expenses of foreclosure, amounts advanced pursuant to the insured mortgage to assure compliance with laws or to protect the lien of the insured mortgage prior to the time of acquisition of the estate or interest in the land and secured thereby and reasonable amounts expended to prevent deterioration of improvements, but reduced by the amount of all payments made; or

(iii) the amount paid by any governmental agency or governmental instrumentality, if the agency or instrumentality is the insured claimant, in the acquisition of the estate or interest in satisfaction of its insurance contract or guaranty.

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 or the lien of the insured mortgage, 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 or the lien of the insured mortgage, 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 or the lien of the insured mortgage, 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 or 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 or the lien of the insured mortgage, 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, unless prohibited by law or governmental regulation, 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 or to Purchase the Indebtedness.

(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; or

(ii) to purchase the indebtedness secured by the insured mortgage for the amount owing thereon together with any costs, attorneys' fees and expenses incurred by the insured claimant which were authorized by the Company up to the time of purchase and which the Company is obligated to pay.

If the Company offers to purchase the indebtedness as herein provided, the owner of the indebtedness shall transfer, assign, and convey the indebtedness and the insured mortgage, together with any collateral security, to the Company upon payment therefor.

Upon the exercise by the Company of either of the options provided for in paragraphs a(i) or (ii), all liability and obligations to the insured under this policy, other than to make the payment required in those paragraphs, 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) <u>To Pay or Otherwise Settle With Parties Other than the Insured or With the Insured Claimant.</u>

(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 AND EXTENT OF LIABILITY

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, if applicable, the amount of insurance as defined in Section 2 (c) of these Conditions and Stipulations;

(ii) the amount of the unpaid principal indebtedness secured by the insured mortgage as limited or provided under Section 8 of these Conditions and Stipulations or as reduced under Section 9 of these Conditions and Stipulations, at the time the loss or

damage insured against by this policy occurs, together with interest thereon; or

(iii) 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 insured has acquired the estate or interest in the manner described in Section 2(a) of these Conditions and Stipulations or has conveyed the title, then the liability of the Company shall continue as set forth in Section 7(a) of these Conditions and Stipulations.

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

8. 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, or otherwise establishes the lien of the insured mortgage, 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 or to the lien of the insured mortgage, 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.

(d) The Company shall not be liable for: (i) any indebtedness created subsequent to Date of Policy except for advances made to protect the lien of the insured mortgage and secured thereby and reasonable amounts expended to prevent deterioration of improvements; or (ii) construction loan advances made subsequent to Date of Policy, except construction loan advances made subsequent to Date of Policy for the purpose of financing in whole or in part the construction of an improvement to the land which at Date of Policy were secured by the insured mortgage and which the insured was and continued to be obligated to advance at and after Date of Policy.

9. REDUCTION OF INSURANCE; REDUCTION OR TERMINATION OF LIABILITY

(a) All payments under this policy, except payments made for costs, attorneys' fees and expenses, shall reduce the amount of the insurance pro tanto. However, any payments made prior to the acquisition of title to the estate or interest as provided in Section 2(a) of these Conditions and Stipulations shall not reduce pro tanto the amount of the insurance afforded under this policy except to the extent that the payments reduce the amount of the indebtedness secured by the insured mortgage.

(b) Payment in part by any person of the principal of the indebtedness, or any other obligation secured by the insured mortgage, or any voluntary partial satisfaction or release of the insured mortgage, to the extent of the payment, satisfaction or release, shall reduce the amount of insurance pro tanto. The amount of insurance may thereafter be increased by accruing interest and advances made to protect the lien of the insured mortgage and secured thereby, with interest thereon, provided in no event shall the amount of insurance be greater than the Amount of Insurance stated in Schedule A.

(c) Payment in full by any person or the voluntary satisfaction or release of the insured mortgage shall terminate all liability of the Company except as provided in Section 2(a) of these Conditions and Stipulations.

10. LIABILITY NONCUMULATIVE.

If the insured acquires title to the estate or interest in satisfaction of the indebtedness secured by the insured mortgage, or any part thereof, 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.

11. 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.

12. 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 all rights and remedies of the insured claimant after the insured claimant shall have recovered its principal, interest, and costs of collection.

(b) The Insured's Rights and Limitations.

Notwithstanding the foregoing, the owner of the indebtedness secured by the insured mortgage, provided the priority of the lien of the insured mortgage or its enforceability is not affected, may release or substitute the personal liability of any debtor or guarantor, or extend or otherwise modify the terms of payment, or release a portion of the estate or interest from the lien of the insured mortgage, or release any collateral security for the indebtedness.

When the permitted acts of the insured claimant occur and the insured has knowledge of any claim of title or interest adverse to the title to the estate or interest or the priority or enforceability of the lien of the insured mortgage, as insured, the Company 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.

(c) 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, guarantees, 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.

The Company's right of subrogation shall not be avoided by acquisition of the insured mortgage by an obligor (except an obligor described in Section 1(a)(ii) of these Conditions and Stipulations) who acquires the insured mortgage as a result of an indemnity, guarantee, other policy of insurance, or bond and the obligor will not be an insured under this policy, notwithstanding Section 1(a)(i) of these Conditions and Stipulations.

13. 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.

14. 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 lien of the insured mortgage or 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.

15. SEVERABILITY.

In the event any provision of this 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.

16. 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

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Appendix J

ALTA Loan Policy (2006)



LOAN POLICY OF TITLE INSURANCE

Issued by

Blank Title Insurance Company

Any notice of claim and any other notice or statement in writing required to be given to the Company under this policy must be given to the Company at the address shown in Section 17 of the Conditions.

COVERED RISKS

SUBJECT TO THE EXCLUSIONS FROM COVERAGE, THE EXCEPTIONS FROM COVERAGE CONTAINED IN SCHEDULE B, AND THE CONDITIONS, BLANK TITLE INSURANCE COMPANY, a Blank corporation (the "Company") insures as of Date of Policy and, to the extent stated in Covered Risks 11, 13, and 14, after Date of Policy, against loss or damage, not exceeding the Amount of Insurance, sustained or incurred by the Insured by reason of:

1. Title being vested other than as stated in Schedule A.

2. Any defect in or lien or encumbrance on the Title. This Covered Risk includes but is not limited to insurance against loss from

   (a) A defect in the Title caused by

      (i) forgery, fraud, undue influence, duress, incompetency, incapacity, or impersonation;

      (ii) failure of any person or Entity to have authorized a transfer or conveyance;

      (iii) a document affecting Title not properly created, executed, witnessed, sealed, acknowledged, notarized, or delivered;

      (iv) failure to perform those acts necessary to create a document by electronic means authorized by law;

      (v) a document executed under a falsified, expired, or otherwise invalid power of attorney;

      (vi) a document not properly filed, recorded, or indexed in the Public Records including failure to perform those acts by electronic means authorized by law; or

      (vii) a defective judicial or administrative proceeding.

   (b) The lien of real estate taxes or assessments imposed on the Title by a governmental authority due or payable, but unpaid.

   (c) Any encroachment, encumbrance, violation, variation, or adverse circumstance affecting the Title that would be disclosed by an accurate and complete land survey of the Land. The term "encroachment" includes encroachments of existing improvements located on the Land onto adjoining land, and encroachments onto the Land of existing improvements located on adjoining land.

3. Unmarketable Title.

4. No right of access to and from the Land.

5. The violation or enforcement of any law, ordinance, permit, or governmental regulation (including those relating to building and zoning) restricting, regulating, prohibiting, or relating to

   (a) the occupancy, use, or enjoyment of the Land;

(b) the character, dimensions, or location of any improvement erected on the Land;

(c) the subdivision of land; or

(d) environmental protection

if a notice, describing any part of the Land, is recorded in the Public Records setting forth the violation or intention to enforce, but only to the extent of the violation or enforcement referred to in that notice.

6. An enforcement action based on the exercise of a governmental police power not covered by Covered Risk 5 if a notice of the enforcement action, describing any part of the Land, is recorded in the Public Records, but only to the extent of the enforcement referred to in that notice.

7. The exercise of the rights of eminent domain if a notice of the exercise, describing any part of the Land, is recorded in the Public Records.

8. Any taking by a governmental body that has occurred and is binding on the rights of a purchaser for value without Knowledge.

9. The invalidity or unenforceability of the lien of the Insured Mortgage upon the Title. This Covered Risk includes but is not limited to insurance against loss from any of the following impairing the lien of the Insured Mortgage

(a) forgery, fraud, undue influence, duress, incompetency, incapacity, or impersonation;

(b) failure of any person or Entity to have authorized a transfer or conveyance;

(c) the Insured Mortgage not being properly created, executed, witnessed, sealed, acknowledged, notarized, or delivered;

(d) failure to perform those acts necessary to create a document by electronic means authorized by law;

(e) a document executed under a falsified, expired, or otherwise invalid power of attorney;

(f) a document not properly filed, recorded, or indexed in the Public Records including failure to perform those acts by electronic means authorized by law; or

(g) a defective judicial or administrative proceeding.

10. The lack of priority of the lien of the Insured Mortgage upon the Title over any other lien or encumbrance.

11. The lack of priority of the lien of the Insured Mortgage upon the Title

(a) as security for each and every advance of proceeds of the loan secured by the Insured Mortgage over any statutory lien for services, labor, or material arising from construction of an improvement or work related to the Land when the improvement or work is either

(i) contracted for or commenced on or before Date of Policy; or

(ii) contracted for, commenced, or continued after Date of Policy if the construction is financed, in whole or in part, by proceeds of the loan secured by the Insured Mortgage that the Insured has advanced or is obligated on Date of Policy to advance; and

(b) over the lien of any assessments for street improvements under construction or completed at Date of Policy.

12. 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.

13. The invalidity, unenforceability, lack of priority, or avoidance of the lien of the Insured Mortgage upon the Title

(a) resulting from the avoidance in whole or in part, or from a court order providing an alternative remedy, of any transfer of all or any part of the title to or any interest in the Land occurring prior to the transaction creating the lien of the Insured Mortgage because that prior transfer constituted a fraudulent or preferential transfer under federal bankruptcy, state insolvency, or similar creditors' rights laws; or

(b) because the Insured Mortgage constitutes a preferential transfer under federal bankruptcy, state insolvency, or similar creditors' rights laws by reason of the failure of its recording in the Public Records

(i) to be timely, or

(ii) to impart notice of its existence to a purchaser for value or to a judgment or lien creditor.

14. Any defect in or lien or encumbrance on the Title or other matter included in Covered Risks 1 through 13 that has been created or attached or has been filed or recorded in the Public Records subsequent to Date of Policy and prior to the recording of the Insured Mortgage in the Public Records.

The Company will also pay the costs, attorneys' fees, and expenses incurred in defense of any matter insured against by this Policy, but only to the extent provided in the Conditions.

[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 that arise by reason of:

1. (a) Any law, ordinance, permit, or governmental regulation (including those relating to building and zoning) restricting, regulating, prohibiting, or relating to

   (i) the occupancy, use, or enjoyment of the Land;

   (ii) the character, dimensions, or location of any improvement erected on the Land;

   (iii) the subdivision of land; or

   (iv) environmental protection;

   or the effect of any violation of these laws, ordinances, or governmental regulations. This Exclusion 1(a) does not modify or limit the coverage provided under Covered Risk 5.

   (b) Any governmental police power. This Exclusion 1(b) does not modify or limit the coverage provided under Covered Risk 6.

2. Rights of eminent domain. This Exclusion does not modify or limit the coverage provided under Covered Risk 7 or 8.

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 (however, this does not modify or limit the coverage provided under Covered Risk 11, 13, or 14); or

   (e) resulting in loss or damage that would not have been sustained if the Insured Claimant had paid value for the Insured Mortgage.

4. Unenforceability of the lien of the Insured Mortgage because of the inability or failure of an Insured to comply with applicable doing-business laws of the state where the Land is situated.

5. Invalidity or unenforceability in whole or in part of the lien of the Insured Mortgage that arises out of the transaction evidenced by the Insured Mortgage and is based upon usury or any consumer credit protection or truth-in-lending law.

6. Any claim, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that the transaction creating the lien of the Insured Mortgage, is

   (a) a fraudulent conveyance or fraudulent transfer, or

   (b) a preferential transfer for any reason not stated in Covered Risk 13(b) of this policy.

7. Any lien on the Title for real estate taxes or assessments imposed by governmental authority and created or attaching between Date of Policy and the date of recording of the Insured Mortgage in the Public Records. This Exclusion does not modify or limit the coverage provided under Covered Risk 11(b).

SCHEDULE A

Name and Address of Title Insurance Company:

[File No.:] Policy No.:

Loan No.:

Address Reference:

Amount of Insurance: $ [Premium: $]

Date of Policy: [at a.m./p.m.]

1. Name of Insured:

2. The estate or interest in the Land that is encumbered by the Insured Mortgage is:

3. Title is vested in:

4. The Insured Mortgage and its assignments, if any, are described as follows:

5. The Land referred to in this policy is described as follows:

[6. This policy incorporates by reference those ALTA endorsements selected below:

- ☐ 4-06 (Condominium)
- ☐ 4.1-06
- ☐ 5-06 (Planned Unit Development)
- ☐ 5.1-06
- ☐ 6-06 (Variable Rate)
- ☐ 6.2-06 (Variable Rate–Negative Amortization)
- ☐ 8.1-06 (Environmental Protection Lien)
  Paragraph b refers to the following state statute(s):
- ☐ 9-06 (Restrictions, Encroachments, Minerals)
- ☐ 13.1-06 (Leasehold Loan)
- ☐ 14-06 (Future Advance-Priority)
- ☐ 14.1-06 (Future Advance-Knowledge)
- ☐ 14.3-06 (Future Advance-Reverse Mortgage)
- ☐ 22-06 (Location) The type of improvement is a _____, and the street address is as shown above.]

SCHEDULE B

EXCEPTIONS FROM COVERAGE

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

PART I

SECTION ONE:

1. (a) Taxes or assessments that are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the Public Records; (b) proceedings by a public agency that may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the Public Records.

2. Any facts, rights, interests, or claims that are not shown by the Public Records but that could be ascertained by an inspection of the Land or that may be asserted by persons in possession of the Land.

3. Easements, liens or encumbrances, or claims thereof, not shown by the Public Records.

4. Any encroachment, encumbrance, violation, variation, or adverse circumstance affecting the Title that would be disclosed by an accurate and complete land survey of the Land and not shown by the Public Records.

5. (a) Unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims or title to water, whether or not the matters excepted under (a), (b), or (c) are shown by the Public Records.

SECTION TWO:

PART II

IN ADDITION TO THE MATTERS SET FORTH IN PART I OF THIS SCHEDULE, THE TITLE IS SUBJECT TO THE FOLLOWING MATTERS, AND THE COMPANY INSURES AGAINST LOSS OR DAMAGE SUSTAINED IN THE EVENT THAT THEY ARE NOT SUBORDINATE TO THE LIEN OF THE INSURED MORTGAGE:

CONDITIONS

1. DEFINITION OF TERMS

The following terms when used in this policy mean:

(a) "Amount of Insurance": The amount stated in Schedule A, as may be increased or decreased by endorsement to this policy, increased by Section 8(b) or decreased by Section 10 of these Conditions.

(b) "Date of Policy": The date designated as "Date of Policy" in Schedule A.

(c) "Entity": A corporation, partnership, trust, limited liability company, or other similar legal entity.

(d) "Indebtedness": The obligation secured by the Insured Mortgage including one evidenced by electronic means authorized by law, and if that obligation is the payment of a debt, the Indebtedness is the sum of

(i) the amount of the principal disbursed as of Date of Policy;

(ii) the amount of the principal disbursed subsequent to Date of Policy;

(iii) the construction loan advances made subsequent to Date of Policy for the purpose of financing in whole or in part the construction of an improvement to the Land or related to the Land that the Insured was and continued to be obligated to advance at Date of Policy and at the date of the advance;

(iv) interest on the loan;

(v) the prepayment premiums, exit fees, and other similar fees or penalties allowed by law;

(vi) the expenses of foreclosure and any other costs of enforcement;

(vii) the amounts advanced to assure compliance with laws or to protect the lien or the priority of the lien of the Insured Mortgage before the acquisition of the estate or interest in the Title;

(viii) the amounts to pay taxes and insurance; and

(ix) the reasonable amounts expended to prevent deterioration of improvements;

but the Indebtedness is reduced by the total of all payments and by any amount forgiven by an Insured.

(e) "Insured": The Insured named in Schedule A.

(i) The term "Insured" also includes

(A) the owner of the Indebtedness and each successor in ownership of the Indebtedness, whether the owner or successor owns the Indebtedness for its own account or as a trustee or other fiduciary, except a successor who is an obligor under the provisions of Section 12(c) of these Conditions;

(B) the person or Entity who has "control" of the "transferable record," if the Indebtedness is evidenced by a "transferable record," as these terms are defined by applicable electronic transactions law;

(C) successors to an Insured by dissolution, merger, consolidation, distribution, or reorganization;

(D) successors to an Insured by its conversion to another kind of Entity;

(E) a grantee of an Insured under a deed delivered without payment of actual valuable consideration conveying the Title

(1) if the stock, shares, memberships, or other equity interests of the grantee are wholly-owned by the named Insured,

(2) if the grantee wholly owns the named Insured, or

(3) if the grantee is wholly-owned by an affiliated Entity of the named Insured, provided the affiliated Entity and the named Insured are both wholly-owned by the same person or Entity;

(F) any government agency or instrumentality that is an insurer or guarantor under an insurance contract or guaranty insuring or guaranteeing the Indebtedness secured by the Insured Mortgage, or any part of it, whether named as an Insured or not;

(ii) With regard to (A), (B), (C), (D) , and (E) reserving, however, all rights and defenses as to any successor that the Company would have had against any predecessor Insured, unless the successor acquired the Indebtedness as a purchaser for value without Knowledge of the asserted defect, lien, encumbrance, or other matter insured against by this policy.

(f) "Insured Claimant": An Insured claiming loss or damage.

(g) "Insured Mortgage": The Mortgage described in paragraph 4 of Schedule A.

(h) "Knowledge" or "Known": Actual knowledge, not constructive knowledge or notice that may be imputed to an Insured by reason of the Public Records or any other records that impart constructive notice of matters affecting the Title.

(i) "Land": The land described in Schedule A, and affixed improvements that by law constitute real property. The term "Land" does not include any property beyond the lines of the area described in Schedule A, nor any right, title, interest, estate, or easement in abutting streets, roads, avenues, alleys, lanes, ways, or waterways, but this does not modify or limit the extent that a right of access to and from the Land is insured by this policy.

(j) "Mortgage": Mortgage, deed of trust, trust deed, or other security instrument, including one evidenced by electronic means authorized by law.

(k) "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 Covered Risk 5(d), "Public Records" shall also include environmental protection liens filed in the records of the clerk of the United States District Court for the district where the Land is located.

(l) "Title": The estate or interest described in Schedule A.

(m) "Unmarketable Title": Title affected by an alleged or apparent matter that would permit a prospective purchaser or lessee of the Title or lender on the Title or a prospective purchaser of the Insured Mortgage to be released from the obligation to purchase, lease, or lend if there is a contractual condition requiring the delivery of marketable title.

2. CONTINUATION OF INSURANCE

The coverage of this policy shall continue in force as of Date of Policy in favor of an Insured after acquisition of the Title by an Insured or after conveyance by an Insured, but only so long as the Insured retains an estate or interest in the Land, or holds an obligation 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 warranties in any transfer or conveyance of the Title. 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 obligation 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 5(a) of these Conditions, (ii) in case Knowledge shall come to an Insured of any claim of title or interest that is adverse to the Title or the lien of the Insured Mortgage, as insured, and that might cause loss or damage for which the Company may be liable by virtue of this policy, or (iii) if the Title or the lien of the Insured Mortgage, as insured, is rejected as Unmarketable Title. If the Company is prejudiced by the failure of the Insured Claimant to provide prompt notice, the Company's liability to the Insured Claimant under the policy shall be reduced to the extent of the prejudice.

4. PROOF OF LOSS

In the event the Company is unable to determine the amount of loss or damage, the Company may, at its option, require as a condition of payment that the Insured Claimant furnish a signed proof of loss. The proof of loss must describe the defect, lien, encumbrance, or other matter insured against by this policy that 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.

5. DEFENSE AND PROSECUTION OF ACTIONS

(a) Upon written request by the Insured, and subject to the options contained in Section 7 of these Conditions, 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 covered by this policy adverse to the Insured. This obligation is limited to only those stated causes of action alleging matters 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. It 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 that allege matters not insured against by this policy.

(b) The Company shall have the right, in addition to the options contained in Section 7 of these Conditions, at its own cost, to institute and prosecute any action or proceeding or to do any other act that in its opinion may be necessary or desirable to establish the Title or the lien of the Insured Mortgage, 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 to the Insured. The exercise of these rights shall not be an admission of liability or waiver of any provision of this policy. If the Company exercises its rights under this subsection, it must do so diligently.

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

6. DUTY OF INSURED CLAIMANT TO COOPERATE

(a) In all cases where this policy permits or requires the Company to prosecute or provide for the defense of any action or proceeding and any appeals, the Insured shall secure to the Company the right to so prosecute or provide defense in the action or proceeding, including the right 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 securing evidence, obtaining witnesses, prosecuting or defending the action or proceeding, or effecting settlement, and (ii) in any other lawful act that in the opinion of the Company may be necessary or desirable to establish the Title, the lien of the Insured Mortgage, or any other matter 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.

(b) The Company may reasonably require the Insured Claimant to submit to examination under oath by any authorized representative of the Company and to produce for examination, inspection, and copying, at such reasonable times and places as may be designated by the authorized representative of the Company, all records, in whatever medium maintained, including books, ledgers, checks, memoranda, correspondence, reports, e-mails, disks, tapes, and videos whether bearing a date before or after Date of Policy, that 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 of these records in the custody or control of a third party that 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 any reasonably requested information, or grant permission to secure reasonably necessary information from third parties as required in this subsection, unless prohibited by law or governmental regulation, shall terminate any liability of the Company under this policy as to that claim.

7. 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 or to Purchase the Indebtedness.

(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 that were authorized by the Company up to the time of payment or tender of payment and that the Company is obligated to pay; or

(ii) To purchase the Indebtedness for the amount of the Indebtedness on the date of purchase, together with any costs, attorneys' fees, and expenses incurred by the Insured Claimant that were authorized by the Company up to the time of purchase and that the Company is obligated to pay.

When the Company purchases the Indebtedness, the Insured shall transfer, assign, and convey to the Company the Indebtedness and the Insured Mortgage, together with any collateral security.

Upon the exercise by the Company of either of the options provided for in subsections (a)(i) or (ii), all liability and obligations of the Company to the Insured under this policy, other than to make the payment required in those subsections, shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation.

(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. In addition, the Company will pay any costs, attorneys' fees, and expenses incurred by the Insured Claimant that were authorized by the Company up to the time of payment and that 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 that were authorized by the Company up to the time of payment and that the Company is obligated to pay.

Upon the exercise by the Company of either of the options provided for in subsections (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.

8. DETERMINATION AND EXTENT OF LIABILITY

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.

(a) The extent of liability of the Company for loss or damage under this policy shall not exceed the least of

(i) the Amount of Insurance,

(ii) the Indebtedness,

(iii) the difference between the value of the Title as insured and the value of the Title subject to the risk insured against by this policy, or

(iv) if a government agency or instrumentality is the Insured Claimant, the amount it paid in the acquisition of the Title or the Insured Mortgage in satisfaction of its insurance contract or guaranty.

(b) If the Company pursues its rights under Section 5 of these Conditions and is unsuccessful in establishing the Title or the lien of the Insured Mortgage, as insured,

(i) the Amount of Insurance shall be increased by 10%, and

(ii) the Insured Claimant shall have the right to have the loss or damage determined either as of the date the claim was made by the Insured Claimant or as of the date it is settled and paid.

(c) In the event the Insured has acquired the Title in the manner described in Section 2 of these Conditions or has conveyed the Title, then the extent of liability of the Company shall continue as set forth in Section 8(a) of these Conditions.

(d) In addition to the extent of liability under (a), (b), and (c), the Company will also pay those costs, attorneys' fees, and expenses incurred in accordance with Sections 5 and 7 of these Conditions.

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 Unmarketable Title, or establishes the lien of the Insured Mortgage, all as insured, in a reasonably diligent manner by any method, including litigation and the completion of any appeals, it shall have fully performed its obligations with respect to that matter and shall not be liable for any loss or damage caused to the Insured.

(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, adverse to the Title or to the lien of the Insured Mortgage, as insured.

(c) The Company shall not be liable for loss or damage to the 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

(a) All payments under this policy, except payments made for costs, attorneys' fees, and expenses, shall reduce the Amount of Insurance by the amount of the payment. However, any payments made prior to the acquisition of Title as provided in Section 2 of these Conditions shall not reduce the Amount of Insurance afforded under this policy except to the extent that the payments reduce the Indebtedness.

(b) The voluntary satisfaction or release of the Insured Mortgage shall terminate all liability of the Company except as provided in Section 2 of these Conditions.

11. PAYMENT OF LOSS

When liability and the extent of loss or damage have been definitely fixed in accordance with these Conditions, the payment shall be made within 30 days.

12. RIGHTS OF RECOVERY UPON PAYMENT OR SETTLEMENT

(a) The Company's Right to Recover

Whenever the Company shall have settled and paid a claim under this policy, it shall be subrogated and entitled to the rights of the Insured Claimant in the Title or Insured Mortgage and all other rights and remedies in respect to the claim that the Insured Claimant has against any person or property, to the extent of the amount of any loss, costs, attorneys' fees, and expenses paid by the Company. If requested by the Company, the Insured Claimant shall execute documents to evidence the transfer to the Company of these rights and remedies. 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 and remedies.

If a payment on account of a claim does not fully cover the loss of the Insured Claimant, the Company shall defer the exercise of its right to recover until after the Insured Claimant shall have recovered its loss.

(b) The Insured's Rights and Limitations

(i) The owner of the Indebtedness may release or substitute the personal liability of any debtor or guarantor, extend or otherwise modify the terms of payment, release a portion of the Title from the lien of the Insured Mortgage, or release any collateral security for the Indebtedness, if it does not affect the enforceability or priority of the lien of the Insured Mortgage.

(ii) If the Insured exercises a right provided in (b)(i), but has Knowledge of any claim adverse to the Title or the lien of the Insured Mortgage insured against by this policy, the Company shall be required to pay only that part of any losses insured against by this policy that 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.

(c) The Company's Rights Against Noninsured Obligors

The Company's right of subrogation includes the Insured's rights against non-insured obligors including the rights of the Insured to indemnities, guaranties, other policies of insurance, or bonds, notwithstanding any terms or conditions contained in those instruments that address subrogation rights.

The Company's right of subrogation shall not be avoided by acquisition of the Insured Mortgage by an obligor (except an obligor described in Section 1(e)(i)(F) of these Conditions) who acquires the Insured Mortgage as a result of an indemnity, guarantee, other policy of insurance, or bond, and the obligor will not be an Insured under this policy.

13. ARBITRATION

Either the Company or the Insured may demand that the claim or controversy shall be submitted to arbitration pursuant to the Title Insurance Arbitration Rules of the American Land Title Association ("Rules"). Except as provided in the Rules, there shall be no joinder or consolidation with claims or controversies of other persons. 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 in connection with its issuance or the breach of a policy provision, or to any other controversy or claim arising out of the transaction giving rise to this policy. All arbitrable matters when the Amount of Insurance is $2,000,000 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 $2,000,000 shall be arbitrated only when agreed to by both the Company and the Insured. Arbitration pursuant to this policy and under the Rules shall be binding upon the parties. Judgment upon the award rendered by the Arbitrator(s) may be entered in any court of competent jurisdiction.

14. LIABILITY LIMITED TO THIS POLICY; POLICY ENTIRE CONTRACT

(a) This policy together with all endorsements, if any, attached to it 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 that arises out of the status of the Title or lien of the Insured Mortgage or by any action asserting such claim shall be restricted to this policy.

(c) Any amendment of or endorsement to this policy must be in writing and authenticated by an authorized person, or expressly incorporated by Schedule A of this policy.

(d) Each endorsement to this policy issued at any time is made a part of this policy and is subject to all of its terms and provisions. Except as the endorsement expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsement, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance.

15. SEVERABILITY

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

16. CHOICE OF LAW; FORUM

(a) Choice of Law: The Insured acknowledges the Company has underwritten the risks covered by this policy and determined the premium charged therefor in reliance upon the law affecting interests in real property and applicable to the interpretation, rights, remedies, or enforcement of policies of title insurance of the jurisdiction where the Land is located.

Therefore, the court or an arbitrator shall apply the law of the jurisdiction where the Land is located to determine the validity of claims against the Title or the lien of the Insured Mortgage that are adverse to the Insured and to interpret and enforce the terms of this policy. In neither case shall the court or arbitrator apply its conflicts of law principles to determine the applicable law.

(b) Choice of Forum: Any litigation or other proceeding brought by the Insured against the Company must be filed only in a state or federal court within the United States of America or its territories having appropriate jurisdiction.

17. NOTICES, WHERE SENT

Any notice of claim and any other notice or statement in writing required to be given to the Company under this policy must be given to the Company at [fill in].

NOTE: Bracketed [ ] material optional

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Appendix K

ALTA Owner's Policy (1992)

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 the 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.

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

Dated: By:

PRESIDENT

Dated: 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:
   (i) the transaction creating the estate or interest insured by this policy being deemed a fraudulent conveyance or fraudulent transfer; or
   (ii) 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:
      (a) to timely record the instrument of transfer; or
      (b) 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 $

Date of Policy _____ (at a.m. or 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:

[POLICY MAY INCLUDE THE FOLLOWING GENERAL EXCEPTIONS IF SO DESIRED BY ISSUING COMPANY:

1. Taxes or assessments which are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the public records.

   Proceedings by a public agency which may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the public records.
2. Any facts, rights, interests or claims which are not shown by the public records but which could be ascertained by an inspection of the land or by making inquiry of persons in possession thereof.
3. Easements, liens or encumbrances, or claims thereof, which are not shown by the public records.
4. Discrepancies, conflicts in boundary lines, shortage in area, encroachments, or any other facts which a correct survey would disclose, and which are not shown by the public records.
5. (a) Unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims or title to water, whether or not the matters excepted under (a), (b) or (c) are shown by the public records.]

[VARIABLE EXCEPTION SUCH AS TAXES, EASEMENTS, CC & Rs, ETC.]

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) <u>To Pay or Tender Payment of the Amount of Insurance.</u>

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.

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) <u>To Pay or Otherwise Settle With Parties Other than the Insured or With the Insured Claimant.</u>

(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

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Appendix L

ALTA Owner's Policy (2006)



OWNER'S POLICY OF TITLE INSURANCE

Issued by

Blank Title Insurance Company

Any notice of claim and any other notice or statement in writing required to be given to the Company under this policy must be given to the Company at the address shown in Section 18 of the Conditions.

COVERED RISKS

SUBJECT TO THE EXCLUSIONS FROM COVERAGE, THE EXCEPTIONS FROM COVERAGE CONTAINED IN SCHEDULE B, AND THE CONDITIONS, BLANK TITLE INSURANCE COMPANY, a Blank corporation (the "Company") insures, as of Date of Policy and, to the extent stated in Covered Risks 9 and 10, after Date of Policy, against loss or damage, not exceeding the Amount of Insurance, sustained or incurred by the Insured by reason of:

1. Title being vested other than as stated in Schedule A.
2. Any defect in or lien or encumbrance on the Title. This Covered Risk includes but is not limited to insurance against loss from
   - (a) A defect in the Title caused by
     - (i) forgery, fraud, undue influence, duress, incompetency, incapacity, or impersonation;
     - (ii) failure of any person or Entity to have authorized a transfer or conveyance;
     - (iii) a document affecting Title not properly created, executed, witnessed, sealed, acknowledged, notarized, or delivered;
     - (iv) failure to perform those acts necessary to create a document by electronic means authorized by law;
     - (v) a document executed under a falsified, expired, or otherwise invalid power of attorney;
     - (vi) a document not properly filed, recorded, or indexed in the Public Records including failure to perform those acts by electronic means authorized by law; or
     - (vii) a defective judicial or administrative proceeding.
   - (b) The lien of real estate taxes or assessments imposed on the Title by a governmental authority due or payable, but unpaid.
   - (c) Any encroachment, encumbrance, violation, variation, or adverse circumstance affecting the Title that would be disclosed by an accurate and complete land survey of the Land. The term "encroachment" includes encroachments of existing improvements located on the Land onto adjoining land, and encroachments onto the Land of existing improvements located on adjoining land.
3. Unmarketable Title.
4. No right of access to and from the Land.

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5. The violation or enforcement of any law, ordinance, permit, or governmental regulation (including those relating to building and zoning) restricting, regulating, prohibiting, or relating to

   (a) the occupancy, use, or enjoyment of the Land;

   (b) the character, dimensions, or location of any improvement erected on the Land;

   (c) the subdivision of land; or

   (d) environmental protection

   if a notice, describing any part of the Land, is recorded in the Public Records setting forth the violation or intention to enforce, but only to the extent of the violation or enforcement referred to in that notice.

6. An enforcement action based on the exercise of a governmental police power not covered by Covered Risk 5 if a notice of the enforcement action, describing any part of the Land, is recorded in the Public Records, but only to the extent of the enforcement referred to in that notice.

7. The exercise of the rights of eminent domain if a notice of the exercise, describing any part of the Land, is recorded in the Public Records.

8. Any taking by a governmental body that has occurred and is binding on the rights of a purchaser for value without Knowledge.

9. Title being vested other than as stated in Schedule A or being defective

   (a) as a result of the avoidance in whole or in part, or from a court order providing an alternative remedy, of a transfer of all or any part of the title to or any interest in the Land occurring prior to the transaction vesting Title as shown in Schedule A because that prior transfer constituted a fraudulent or preferential transfer under federal bankruptcy, state insolvency, or similar creditors' rights laws; or

   (b) because the instrument of transfer vesting Title as shown in Schedule A constitutes a preferential transfer under federal bankruptcy, state insolvency, or similar creditors' rights laws by reason of the failure of its recording in the Public Records

      (i) to be timely, or

      (ii) to impart notice of its existence to a purchaser for value or to a judgment or lien creditor.

10. Any defect in or lien or encumbrance on the Title or other matter included in Covered Risks 1 through 9 that has been created or attached or has been filed or recorded in the Public Records subsequent to Date of Policy and prior to the recording of the deed or other instrument of transfer in the Public Records that vests Title as shown in Schedule A.

The Company will also pay the costs, attorneys' fees, and expenses incurred in defense of any matter insured against by this Policy, but only to the extent provided in the Conditions.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

BY:_____
PRESIDENT

BY:_____
SECRETARY

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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 that arise by reason of:

1. (a) Any law, ordinance, permit, or governmental regulation (including those relating to building and zoning) restricting, regulating, prohibiting, or relating to

   (i) the occupancy, use, or enjoyment of the Land;

   (ii) the character, dimensions, or location of any improvement erected on the Land;

   (iii) the subdivision of land; or

   (iv) environmental protection;

   or the effect of any violation of these laws, ordinances, or governmental regulations. This Exclusion 1(a) does not modify or limit the coverage provided under Covered Risk 5.

   (b) Any governmental police power. This Exclusion 1(b) does not modify or limit the coverage provided under Covered Risk 6.

2. Rights of eminent domain. This Exclusion does not modify or limit the coverage provided under Covered Risk 7 or 8.

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 (however, this does not modify or limit the coverage provided under Covered Risk 9 and 10); or

   (e) resulting in loss or damage that would not have been sustained if the Insured Claimant had paid value for the Title.

4. Any claim, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that the transaction vesting the Title as shown in Schedule A, is

   (a) a fraudulent conveyance or fraudulent transfer; or

   (b) a preferential transfer for any reason not stated in Covered Risk 9 of this policy.

5. Any lien on the Title for real estate taxes or assessments imposed by governmental authority and created or attaching between Date of Policy and the date of recording of the deed or other instrument of transfer in the Public Records that vests Title as shown in Schedule A.

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SCHEDULE A

Name and Address of Title Insurance Company:

[File No.:] Policy No.:

Address Reference:

Amount of Insurance: $ [Premium: $]

Date of Policy: [at a.m./p.m.]

1. Name of Insured:

2. The estate or interest in the Land that is insured by this policy is:

3. Title is vested in:

4. The Land referred to in this policy is described as follows:



SCHEDULE B

EXCEPTIONS FROM COVERAGE

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

PART ONE:

1. (a) Taxes or assessments that are not shown as existing liens by the records of any taxing authority that levies taxes or assessments on real property or by the Public Records; (b) proceedings by a public agency that may result in taxes or assessments, or notices of such proceedings, whether or not shown by the records of such agency or by the Public Records.

2. Any facts, rights, interests, or claims that are not shown by the Public Records but that could be ascertained by an inspection of the Land or that may be asserted by persons in possession of the Land.

3. Easements, liens or encumbrances, or claims thereof, not shown by the Public Records.

4. Any encroachment, encumbrance, violation, variation, or adverse circumstance affecting the Title that would be disclosed by an accurate and complete land survey of the Land and not shown by the Public Records.

5. (a) Unpatented mining claims; (b) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (c) water rights, claims or title to water, whether or not the matters excepted under (a), (b), or (c) are shown by the public records.

PART TWO:

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CONDITIONS

1. DEFINITION OF TERMS

The following terms when used in this policy mean:

(a) "Amount of Insurance": The amount stated in Schedule A, as may be increased or decreased by endorsement to this policy, increased by Section 8(b), or decreased by Sections 10 and 11 of these Conditions.

(b) "Date of Policy": The date designated as "Date of Policy" in Schedule A.

(c) "Entity": A corporation, partnership, trust, limited liability company, or other similar legal entity.

(d) "Insured": The Insured named in Schedule A.

(i) The term "Insured" also includes

(A) successors to the Title of the Insured by operation of law as distinguished from purchase, including heirs, devisees, survivors, personal representatives, or next of kin;

(B) successors to an Insured by dissolution, merger, consolidation, distribution, or reorganization;

(C) successors to an Insured by its conversion to another kind of Entity;

(D) a grantee of an Insured under a deed delivered without payment of actual valuable consideration conveying the Title

(1) if the stock, shares, memberships, or other equity interests of the grantee are wholly-owned by the named Insured,

(2) if the grantee wholly owns the named Insured,

(3) if the grantee is wholly-owned by an affiliated Entity of the named Insured, provided the affiliated Entity and the named Insured are both wholly-owned by the same person or Entity, or

(4) if the grantee is a trustee or beneficiary of a trust created by a written instrument established by the Insured named in Schedule A for estate planning purposes.

(ii) With regard to (A), (B), (C), and (D) reserving, however, all rights and defenses as to any successor that the Company would have had against any predecessor Insured.

(e) "Insured Claimant": An Insured claiming loss or damage.

(f) "Knowledge" or "Known": Actual knowledge, not constructive knowledge or notice that may be imputed to an Insured by reason of the Public Records or any other records that impart constructive notice of matters affecting the Title.

(g) "Land": The land described in Schedule A, and affixed improvements that by law constitute real property. The term "Land" does not include any property beyond the lines of the area described in Schedule A, nor any right, title, interest, estate, or easement in abutting streets, roads, avenues, alleys, lanes, ways, or waterways, but this does not modify or limit the extent that a right of access to and from the Land is insured by this policy.

(h) "Mortgage": Mortgage, deed of trust, trust deed, or other security instrument, including one evidenced by electronic means authorized by law.

(i) "Public Records": Records established under state statutes at Date of Policy for the purpose of imparting

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constructive notice of matters relating to real property to purchasers for value and without Knowledge. With respect to Covered Risk 5(d), "Public Records" shall also include environmental protection liens filed in the records of the clerk of the United States District Court for the district where the Land is located.

(j) "Title": The estate or interest described in Schedule A.

(k) "Unmarketable Title": Title affected by an alleged or apparent matter that would permit a prospective purchaser or lessee of the Title or lender on the Title to be released from the obligation to purchase, lease, or lend if there is a contractual condition requiring the delivery of marketable title.

2. CONTINUATION OF INSURANCE

The coverage of this policy shall continue in force as of Date of Policy in favor of an Insured, but only so long as the Insured retains an estate or interest in the Land, or holds an obligation 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 warranties in any transfer or conveyance of the Title. 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 obligation 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 5(a) of these Conditions, (ii) in case Knowledge shall come to an Insured hereunder of any claim of title or interest that is adverse to the Title, as insured, and that might cause loss or damage for which the Company may be liable by virtue of this policy, or (iii) if the Title, as insured, is rejected as Unmarketable Title. If the Company is prejudiced by the failure of the Insured Claimant to provide prompt notice, the Company's liability to the Insured Claimant under the policy shall be reduced to the extent of the prejudice.

4. PROOF OF LOSS

In the event the Company is unable to determine the amount of loss or damage, the Company may, at its option, require as a condition of payment that the Insured Claimant furnish a signed proof of loss. The proof of loss must describe the defect, lien, encumbrance, or other matter insured against by this policy that 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.

5. DEFENSE AND PROSECUTION OF ACTIONS

(a) Upon written request by the Insured, and subject to the options contained in Section 7 of these Conditions, 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 covered by this policy adverse to the Insured. This obligation is limited to only those stated causes of action alleging matters 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. It 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 that allege matters not insured against by this policy.

(b) The Company shall have the right, in addition to the options contained in Section 7 of these Conditions, at its own cost, to institute and prosecute any action or proceeding or to do any other act that in its opinion may be necessary or desirable to establish the Title, 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 to the Insured. The exercise of these rights shall not be an admission of liability or waiver of any provision of this policy. If the Company exercises its rights under this subsection, it must do so diligently.

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

6. DUTY OF INSURED CLAIMANT TO COOPERATE

(a) In all cases where this policy permits or requires the Company to prosecute or provide for the defense of any action or proceeding and any appeals, the Insured shall secure to the Company the right to so prosecute or provide defense in the action or proceeding, including the right 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 securing evidence, obtaining witnesses, prosecuting or defending the action or proceeding, or effecting settlement, and (ii) in any other lawful act that in the opinion of the Company may be necessary or desirable to establish the Title or any other matter 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.

(b) The Company may reasonably require the Insured Claimant to submit to examination under oath by any authorized representative of the Company and to produce for examination, inspection, and copying, at such reasonable times and places as may be designated by the authorized representative of the Company, all records, in whatever medium maintained, including books, ledgers, checks, memoranda, correspondence, reports, e-mails, disks, tapes, and videos whether bearing a date before or after Date of Policy, that 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 of these records in the custody or control of a third party that 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 any reasonably requested information, or grant permission to secure reasonably necessary information from third parties as required in this subsection, unless prohibited by law or governmental regulation, shall terminate any liability of the Company under this policy as to that claim.

7. 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.

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 that were authorized by the Company up to the time of payment or tender of payment and that the Company is obligated to pay.

Upon the exercise by the Company of this option, all liability and obligations of the Company to the Insured under this policy, other than to make the payment required in this subsection, shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation.

(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

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against under this policy. In addition, the Company will pay any costs, attorneys' fees, and expenses incurred by the Insured Claimant that were authorized by the Company up to the time of payment and that 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 that were authorized by the Company up to the time of payment and that the Company is obligated to pay.

Upon the exercise by the Company of either of the options provided for in subsections (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.

8. DETERMINATION AND EXTENT OF LIABILITY

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.

(a) he extent of liability of the Company for loss or damage under this policy shall not exceed the lesser of

(i) the Amount of Insurance; or

(ii) the difference between the value of the Title as insured and the value of the Title subject to the risk insured against by this policy.

(b) If the Company pursues its rights under Section 5 of these Conditions and is unsuccessful in establishing the Title, as insured,

(i) the Amount of Insurance shall be increased by 10%, and

(ii) the Insured Claimant shall have the right to have the loss or damage determined either as of the date the claim was made by the Insured Claimant or as of the date it is settled and paid.

(c) In addition to the extent of liability under (a) and (b), the Company will also pay those costs, attorneys' fees, and expenses incurred in accordance with Sections 5 and 7 of these Conditions.

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 Unmarketable Title, all as insured, in a reasonably diligent manner by any method, including litigation and the completion of any appeals, it shall have fully performed its obligations with respect to that matter and shall not be liable for any loss or damage caused to the Insured.

(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, adverse to the Title, as insured.

(c) The Company shall not be liable for loss or damage to the 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 Insurance by the amount of the payment.

11. LIABILITY NONCUMULATIVE

The Amount of Insurance shall be reduced by any amount the Company pays 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 executed by an Insured after Date of Policy and which is a charge or lien on the Title, and the amount so paid shall be deemed a payment to the Insured under this policy.

12. PAYMENT OF LOSS

When liability and the extent of loss or damage have been definitely fixed in accordance with these Conditions, the payment shall be made within 30 days.

13. RIGHTS OF RECOVERY UPON PAYMENT OR SETTLEMENT

(a) Whenever the Company shall have settled and paid a claim under this policy, it shall be subrogated and entitled to the rights of the Insured Claimant in the Title and all other rights and remedies in respect to the claim that the Insured Claimant has against any person or property, to the extent of the amount of any loss, costs, attorneys' fees, and expenses paid by the Company. If requested by the Company, the Insured Claimant shall execute documents to evidence the transfer to the Company of these rights and remedies. 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 and remedies.

If a payment on account of a claim does not fully cover the loss of the Insured Claimant, the Company shall defer the exercise of its right to recover until after the Insured Claimant shall have recovered its loss.

(b) The Company's right of subrogation includes the rights of the Insured to indemnities, guaranties, other policies of insurance, or bonds, notwithstanding any terms or conditions contained in those instruments that address subrogation rights.

14. ARBITRATION

Either the Company or the Insured may demand that the claim or controversy shall be submitted to arbitration pursuant to the Title Insurance Arbitration Rules of the American Land Title Association ("Rules"). Except as provided in the Rules, there shall be no joinder or consolidation with claims or controversies of other persons. 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 in connection with its issuance or the breach of a policy provision, or to any other controversy or claim arising out of the transaction giving rise to this policy. All arbitrable matters when the Amount of Insurance is $2,000,000 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 $2,000,000 shall be arbitrated only when agreed to by both the Company and the Insured. Arbitration pursuant to this policy and under the Rules shall be binding upon the parties. Judgment upon the award rendered by the Arbitrator(s) may be entered in any court of competent jurisdiction.



15. LIABILITY LIMITED TO THIS POLICY; POLICY ENTIRE CONTRACT

(a) This policy together with all endorsements, if any, attached to it 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 that arises out of the status of the Title or by any action asserting such claim shall be restricted to this policy.

(c) Any amendment of or endorsement to this policy must be in writing and authenticated by an authorized person, or expressly incorporated by Schedule A of this policy.

(d) Each endorsement to this policy issued at any time is made a part of this policy and is subject to all of its terms and provisions. Except as the endorsement expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsement, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance.

16. SEVERABILITY

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

17. CHOICE OF LAW; FORUM

(a) Choice of Law: The Insured acknowledges the Company has underwritten the risks covered by this policy and determined the premium charged therefor in reliance upon the law affecting interests in real property and applicable to the interpretation, rights, remedies, or enforcement of policies of title insurance of the jurisdiction where the Land is located.

Therefore, the court or an arbitrator shall apply the law of the jurisdiction where the Land is located to determine the validity of claims against the Title that are adverse to the Insured and to interpret and enforce the terms of this policy. In neither case shall the court or arbitrator apply its conflicts of law principles to determine the applicable law.

(b) Choice of Forum: Any litigation or other proceeding brought by the Insured against the Company must be filed only in a state or federal court within the United States of America or its territories having appropriate jurisdiction.

18. NOTICES, WHERE SENT

Any notice of claim and any other notice or statement in writing required to be given to the Company under this policy must be given to the Company at [fill in].

NOTE: Bracketed [ ] material optional

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Appendix M

ALTA Residential Title Insurance Policy (1987)

BLANK TITLE INSURANCE COMPANY

RESIDENTIAL TITLE INSURANCE POLICY — ONE-TO-FOUR FAMILY RESIDENCES

OWNER'S INFORMATION SHEET

Your Title Insurance Policy is a legal contract between you and Blank Title Insurance Company.

It applies only to a one-to-four family residential lot or condominium unit. If your land is not either of these, contact us immediately.

The Policy insures you against certain risks to your land title. These risks are listed on page one of the Policy. The Policy is limited by:

Exclusions on page

Exceptions on Schedule B

Conditions on pages

You should keep the Policy even if you transfer the title to your land.

If you want to make a claim, see Item 3 under Conditions on page

You do not owe any more premiums for the Policy.

This sheet is not your insurance Policy. It is only a brief outline of some of the important Policy features. The Policy explains in detail your rights and obligations and our rights and obligations. Since the Policy—and not this sheet—is the legal document, YOU SHOULD READ THE POLICY VERY CAREFULLY.

If you have any questions about your Policy, contact:

BLANK TITLE INSURANCE COMPANY

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RESIDENTIAL TITLE INSURANCE POLICY—ONE-TO-FOUR FAMILY RESIDENCES

OWNER'S COVERAGE STATEMENT

This policy insures your title to the land described in Schedule A—if that land is a one-to-four family residential lot or condominium unit.

Your insurance, as described in this Coverage Statement, is effective on the Policy Date shown in Schedule A.

Your insurance is limited by the following:

Exclusions on page

Exceptions in Schedule B

Conditions on pages

We insure you against actual loss resulting from:

any title risks covered by this Policy—up to the Policy Amount

and

any costs, attorneys' fees and expenses we have to pay under this Policy

COVERED TITLE RISKS

This Policy covers the following title risks, if they affect your title on the Policy Date.

1. Someone else owns an interest in your title.
2. A document is not property signed, sealed, acknowledged, or delivered.
3. Forgery, fraud, duress, incompetency, incapacity or impersonation.
4. Defective recording of any document.
5. You do not have any legal right of access to and from the land.
6. There are restrictive covenants limiting your use of the land.
7. There is a lien on your title because of:
   a mortgage or deed of trust
   a judgment, tax, or special assessment
   a charge by a homeowner's or condominium association
8. There are liens on your title, arising now or later, for labor and material furnished before the Policy Date—unless you agreed to pay for the labor and material.
9. Others have rights arising out of leases, contracts, or options.
10. Someone else has an easement on your land.
11. Your title is unmarketable, which allows another person to refuse to perform a contract to purchase, to lease or to make a mortgage loan.
12. You are forced to remove your existing structure—other than a boundary wall or fence—because:
    it extends on to adjoining land or on to any easement
    it violates a restriction shown in Schedule B
    it violates an existing zoning law
13. You cannot use the land because use as a single-family residence violates a restriction shown in Schedule B or an existing zoning law.
14. Other defects, liens, or encumbrances.

COMPANY'S DUTY TO DEFEND AGAINST COURT CASES

We will defend your title in any court case as to that part of the case that is based on a Covered Title Risk insured against by this Policy. We will pay the costs, attorneys' fees, and expenses we incur in that defense.

We can end this duty to defend your title by exercising any of our options listed in Item 4 of the Conditions.

This Policy is not complete without Schedule A and B.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By:

PRESIDENT

BY:

SECRETARY

SCHEDULE A

Policy Number:

Policy Date:

Policy Amount:

Policy Premium:

1. Name of insured:
2. Your interest in the land covered by this Policy is:
3. The land referred to in this Policy is described as follows:

SCHEDULE B

EXCEPTIONS

In addition to the Exclusions, you are not insured against loss, costs, attorneys' fees, and expenses resulting from:

EXCLUSIONS

In addition to the Exceptions in Schedule B, you are not insured against loss, costs, attorneys' fees, and expenses resulting from:

1. Governmental police power, and the existence or violation of any law or government regulation. This includes building and zoning ordinances and also laws and regulations concerning:
   land use

improvements on the land

land division

environmental protection

This exclusion does not apply to violations or the enforcement of these matters which appear in the public records at Policy Date.

This exclusion does not limit the zoning coverage described in Items 12 and 13 of Covered Title Risks.

2. The right to take the land by condemning it, unless:

   a notice of exercising the right appears in the public records on the Policy Date

   the taking happened prior to the Policy Date and is binding on you if you bought the land without knowing of the taking

3. Title Risks:

   that are created, allowed, or agreed to by you

   that are known to you, but not to us, on the Policy Date—unless they appeared in the public records

   that result in no loss to you

   that first affect your title after the Policy Date—this does not limit the labor and material lien coverage in Item 8 of Covered Title Risks

4. Failure to pay value for your title.

5. Lack of a right:

   to any land outside the area specifically described and referred to in Item 3 of Schedule A

   or

   in streets, alleys, or waterways that touch your land

This exclusion does not limit the access coverage in Item 5 of Covered Title Risks.

CONDITIONS

1. DEFINITIONS

   a. Easement-the right of someone else to use your land for a special purpose.

   b. Land-the land or condominium unit described in Schedule A and any improvements on the land which are real property.

   c. Mortgage-a mortgage, deed of trust, trust deed or other security instrument.

   d. Public Records-title records that give constructive notice of matters affecting your title—according to the state statutes where your land is located.

   e. Title-the ownership of your interest in the land, as shown in Schedule A.

2. CONTINUATION OF COVERAGE

   This Policy protects you as long as you:

   own your title

   or

   own a mortgage from anyone who buys your land

   or

   are liable for any title warranties you make

   This Policy protects anyone who receives your title because of your death.

3. HOW TO MAKE A CLAIM

   a. You Must Give the Company Notice of Your Claim

   If anyone claims a right against your insured title, you must notify us promptly in writing.

   Send the notice to . Please include the Policy number shown in Schedule A, and the county and state where the land is located.

   Our obligation to you could be reduced if:

   you fail to give prompt notice

   and

   your failure affects our ability to dispose of or to defend you against the claim

   b. Proof of Your Loss Must Be Given to the Company

   You must give us a written statement to prove your claim of loss. This statement must be given to us not later than 90 days after you know the facts which will let you establish the amount of your loss.

   The statement must have the following facts:

   the Covered Title Risks which resulted in your loss

   the dollar amount of your loss

   the method you used to compute the amount of your loss

   You may want to provide us with an appraisal of your loss by a professional appraiser as a part of your statement of loss.

   We may require you to show us your records, checks, letters, contracts, and other papers which relate to your claim of loss. We may make copies of these papers.

   We may require you to answer questions under oath.

Our obligation to you could be reduced if you fail or refuse to:

provide a statement of loss

or

answer our questions under oath

or

show us the papers we request,

and

your failure or refusal affects our ability to dispose of or to defend you against the claim.

4. OUR CHOICES WHEN YOU NOTIFY US OF A CLAIM

After we receive your claim notice or in any other way learn of a matter for which we are liable, we can do one or more of the following:

a. Pay the claim against your title.
b. Negotiate a settlement.
c. Prosecute or defend a court case related to the claim.
d. Pay you the amount required by this Policy.
e. Take other action which will protect you.
f. Cancel this policy by paying the Policy Amount, then in force, and only those costs, attorneys' fees and expenses incurred up to that time which we are obligated to pay.

5. HANDLING A CLAIM OR COURT CASE

You must cooperate with us in handling any claim or court case and give us all relevant information.

We are required to repay you only for those settlement costs, attorneys' fees and expenses that we approve in advance.

When we defend your title, we have a right to choose the attorney. We can appeal any decision to the highest court. We do not have to pay your claim until your case is finally decided.

6. LIMITATION OF THE COMPANY'S LIABILITY

a. We will pay up to your actual loss or the Policy Amount in force when the claim is made—whichever is less.
b. If we remove the claim against your title within a reasonable time after receiving notice of it, we will have no further liability for it.

If you cannot use any of your land because of a claim against your title, and you rent reasonable substitute land or facilities, we will repay your for your actual rent until:

the cause of the claim is removed

or

we settle your claim

c. The Policy Amount will be reduced by all payments made under this policy—except for costs, attorneys' fees and expenses.
d. The Policy Amount will be reduced by any amount we pay to our insured holder of any mortgage shown in this Policy or a later mortgage given by you.
e. If you do anything to affect any right of recovery you may have, we can subtract from our liability the amount by which you reduced the value of that right.

7. TRANSFER OF YOUR RIGHTS

When we settle a claim, we have all the rights you had against any person or property related to the claim. You must transfer these rights to us when we ask, and you must not do anything to affect these rights. You must let us use your name in enforcing these rights.

We will not be liable to you if we do not pursue these rights or if we do not recover any amount that might be recoverable.

With the money we recover from enforcing these rights, we will pay whatever part of your loss we have not paid. We have a right to keep what is left.

8. ARBITRATION

If it is permitted in your state, you or the Company may demand arbitration.

The arbitration shall be binding on both you and the Company. The arbitration shall decide any matter in dispute between you and the Company.

The arbitration award may:

include attorneys' fees if allowed by state law

be entered as a judgment in the proper court.

The arbitration shall be under the Title Insurance Arbitration Rules of the American Arbitration Association. You may choose current Rules or Rules in existence on Policy Date.

The law used in the arbitration is the law of the place where the property is located.

You can get a copy of the Rules from the Company.

9. OUR LIABILITY IS LIMITED TO THIS POLICY

This Policy, plus any endorsements, is the entire contract between you and the Company. Any claim you make against us must be made under this Policy and is subject to its terms.

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Appendix N

CLTA Endorsements

CLTA No.	*Description*	*Policy Form[1]*
100	Covers loss from present or future violations of CC&Rs, encroachments of improvements, or surface entry for mineral development	Lender: Extended
100.1	Covers loss from present or future violations of CC&Rs, encroachments of improvements, or surface entry for mineral development	Lender: Standard
100.2 (ALTA 9)	Covers loss from present or future violations of CC&Rs, encroachments of improvements, or surface entry for mineral development	Lender: Extended
100.4	Covers loss from present violation of particular provision in CC&Rs	Lender: All policies
100.5	Covers loss from present violation of CC&Rs	Owner: All policies
100.6	Covers loss from present or future violation of CC&Rs	Owner: All policies
100.7	Covers loss from present violation of particular provision in CC&Rs	Owner: All policies
100.8	Covers loss from present or future violation of particular provision in CC&Rs	Owner: All policies
100.12	Insures that reverter, right of reentry, or power of termination in CC&Rs is not enforceable	Lender: Extended
100.13	Insures priority of lien of deed of trust over assessment liens in CC&Rs	Lender: Extended
100.17	Insures that CC&Rs have been properly modified	Owner: All policies Lender: All policies
100.18	Covers loss from exercise of reverter, right of reentry, or power of termination in CC&Rs	Lender: All policies Owner: All policies
100.19	Insures that there are no	Owner: All policies

	present violations of CC&Rs	Lender: All policies
100.20	Covers loss from enforcement of CC&Rs based on present violation of CC&Rs	Owner: All policies Lender: All policies
100.21	Insures approval of plans and specifications as required by CC&Rs	Owner: All policies Lender: All policies
100.23	Covers loss from exercise of right of surface entry under oil and gas lease	Lender: Extended
100.24	Insures that lessee under mineral lease has no right to enter on or use surface	Lender: All policies
100.25	Covers loss from violation of CC&Rs because of subsurface oil drilling	Lessee: Standard (Leasehold)
100.26	Covers loss from damage to improvements resulting from exercise of right to use surface (FHA)	Owner: Standard Lender: All policies
100.27	Covers loss of mortgage lien or title after foreclosure or unmarketability of title resulting from present violation of CC&Rs	Lender: Extended
100.28	Covers loss from present or future violation of particular provision of CC&Rs by future construction	Owner: All policies Lender: All policies
100.29	Covers loss from exercise of surface rights for extraction or development of minerals excepted from description of land or shown as a reservation in Schedule B	Owner: Standard
101	Covers loss from lack of priority of insured mortgage over mechanics' liens	Lender: Standard
101.1	Mechanics' lien insurance—after notice of completion	Owner: All policies
101.2	Mechanics' lien insurance—after notice of completion	Lender: All policies
101.3	Mechanics' lien insurance—no notice of completion	Lender: All policies
101.4	Mechanics' lien insurance—no notice of completion	Owner: Standard
101.5	Mechanics' lien insurance—regularity of recorded notice of completion and no mechanics' liens except as	Lender: All policies when CLTA endorsement 101 is not included in

	listed; liability limited to specific amount	original
101.6	Mechanics' lien insurance—regularity of recorded notice of completion and no mechanics' liens except as listed; liability limited to face amount of policy	Lender: All policies when CLTA endorsement 101 is included in original policy
101.8	Mechanics' lien insurance—covers loss of priority of deed of trust over mechanics' liens arising from separate contract for "off-site" work	Lender: All policies
101.9	Mechanics' lien insurance—notice of completion describes specific work of improvement on only a portion of land covered by policy; liability limited to specified amount	Owner: All policies
101.10	Mechanics' lien insurance—notice of completion describes specific work of improvement on only a portion of land covered by policy; liability limited to specified amount	Lender: All policies
101.11	Mechanics' lien insurance—applies only to portion of land covered by policy—no notice of completion; liability limited to specified amount	Lender: All policies
101.12	Mechanics' lien insurance—applies only to portion of land covered by policy—no notice of completion; liability limited to specified amount	Owner: Standard
101.13	Mechanics' lien insurance—after notice of completion	Lender: All policies
101.14	Mechanics' lien insurance—after notice of completion	Lender: ALTA construction loan policy
101.15	Mechanics' lien insurance—no notice of completion	Lender: ALTA construction loan policy
101.16	Mechanics' lien insurance—after notice of completion on part of land; liability limited to stated amount	Lender: ALTA construction loan policy
101.17	Mechanics' lien insurance—applies only to portion of land covered by policy—no notice of completion; liability limited	Lender: ALTA construction loan policy

	to stated amount	
101.18	Mechanics' lien insurance—after notice of completion	Lender: ALTA construction loan policy
102.4	Insures that foundations are within boundary lines and their location does not violate CC&Rs	Lender: All policies
102.5	Insures that foundations are within boundary lines, their location does not violate CC&Rs, and they do not encroach onto specified easements	Lender: All policies
102.6	Insures that foundations on portions of the land are within boundary lines and their location does not violate CC&Rs	Lender: All policies
102.7	Insures that foundations on portions of the land are within boundary lines, their location does not violate CC&Rs, and they do not encroach onto specified easements	Lender: All policies
103.1	Covers loss from exercise of right of use or maintenance of easement by easement holder	Lender: All policies
103.3	Covers loss from forced removal of improvements that encroach onto easement	Lender: All policies
103.4	Insures that insured easement affords ingress and egress to and from specified public street	Owner: All policies Lender: All policies
103.5	Covers loss from exercise of surface rights for extraction or development of water	Owner: Extended Lender: Extended
103.6	Insures that improvements do not encroach onto specific easement	Lender: Extended
103.7	Insures that land abuts on existing public street	Owner: All policies Lender: All policies
103.8	Covers loss from damage to existing or future improvements (FHA) from exercise of surface rights for extraction or development of water	Lender: All policies
103.9	Covers loss from forced removal of encroachment	Lender: All policies

	onto public street	
103.10	Covers loss from use of surface by owner of land below horizontal division of land	Owner: All policies Lender: All policies
104	Insures (1) validity of recorded assignment of beneficial interest; (2) subsisting real property tax or assessment liens; (3) matters shown by public records that affect validity or priority of insured deed of trust; and (4) federal tax liens or bankruptcy proceedings affecting title to the estate or interest covered by policy	Lender: Extended
104A	Insures (1) validity of recorded assignment of beneficial interest; (2) subsisting real property tax or assessment liens; (3) matters shown by public records that affect validity or priority of insured deed of trust; and (4) federal tax liens or bankruptcy proceedings affecting title to the estate or interest covered by policy	Lender: Standard
104.1	Insures (1) validity of recorded assignment of beneficial interest and (2) full or partial reconveyances, modification, or subordination of insured deed of trust	Lender: All policies
104.4	With respect to collateral assignments, insures (1) validity of recorded assignment and (2) full or partial reconveyances, modification, or subordination of insured deed of trust	Lender: All policies
104.6	Covers loss from (1) defects in execution of assignment of lessor's interest in lease or (2) any prior assignment	Lender: Extended
104.7	Covers loss from prior recorded assignment of rents	Lender: All policies
104.8	Insures (1) validity of recorded assignment of beneficial interest, with qualifications; (2) subsisting real property tax or assessment liens; (3) matters affecting validity or priority of	Lender: Extended

	the insured deed of trust; and (4) federal tax liens or bankruptcy proceedings affecting the estate or interest covered by policy	
104.9	Insures (1) validity of recorded assignment of beneficial interest, with qualifications; (2) subsisting real property tax or assessment liens; (3) matters shown by public records affecting validity or priority of insured deed of trust; and (4) federal tax liens or bankruptcy proceedings affecting the estate or interest covered by policy	Lender: Standard
104.10	Insures (1) validity of recorded assignment of beneficial interest, with qualifications, and (2) full or partial reconveyances, modification, or subordination of insured deed of trust	Lender: All policies
104.11	With respect to collateral assignments, insures (1) validity of recorded assignment, with qualifications, and (2) full or partial reconveyances, modification, or subordination of insured deed of trust	Lender: All policies
104.12 (ALTA 10)	Covers loss from (1) failure of assignment to vest title to insured deed of trust and (2) modification, reconveyance, release, or discharge of lien of recorded deed of trust	Lender: Extended
105	Accommodates insuring two or more deeds of trust under a single policy	Lender: Standard
105.1	Accommodates insuring two or more deeds of trust under a single policy	Lender: CLTA
106	Insures State of California concerning release or relinquishment of access rights, by voluntary conveyance, with respect to grantor's remaining land, if grantor has conveyed abutting land for a freeway or limited access highway	Owner: Standard
106C	Insures State of California	Owner: Standard

	concerning elimination of access rights, by condemnation, for abutting land if condemned land is for a freeway or limited-access highway	
106.1	Insures State of California concerning release or relinquishment of access rights only, by voluntary conveyance, with respect to land abutting freeway or limited-access highway	Owner: Standard
106.1C	Insures State of California concerning elimination of access rights only, by condemnation, with respect to land abutting freeway or limited-access highway	Owner: Standard
106.2	Insures State of California concerning release or relinquishment of access rights only, by voluntary conveyance, with respect to (1) grantor's remaining land, if grantor has conveyed portion of land for freeway or limited-access highway, and to (2) other land abutting such freeway or limited-access highway	Owner: Standard
106.2C	Insures State of California concerning elimination of access rights only, by condemnation, with respect to (1) owner's remaining land if a portion of that land was condemned for freeway or limited-access highway and to (2) other land abutting such freeway or limited-access highway	Owner: Standard
107.1	Allocates a designated amount of total liability of policy to each parcel described in Schedule A	All policies
107.2	Increases amount of insurance following issuance of policy	All policies
107.5	Covers improvements (even if lease designates them as personal property) for purposes of establishing damages	Lender: Leasehold
107.9	Adds additional insured under	All policies

	existing policy, with qualifications	
107.10	Adds additional insured under existing policy	All policies
107.11	Covers loss from invalidity or unenforceability of insured deed of trust if beneficiary has also acquired fee interest	Lender: Extended rewrite
108.7	Covers loss concerning (1) vesting of title and (2) subsistence and priority of insured deed of trust with respect to securing additional (optional) advance and increases policy liability by amount of advance	Lender: Standard
108.8	Covers loss concerning (1) vesting of title and (2) subsistence and priority of insured deed of trust with respect to securing additional (optional) advance and increases policy liability by amount of advance	Lender: Extended
108.9	Covers Department of Veterans Affairs loss concerning vesting of title and defects in or liens or encumbrances on title with respect to advance made under purchase agreement with veteran	Owner: Standard
108.10	Covers defined loss relating to (1) vesting of title and (2) continued priority of insured deed of trust insofar as it secures increased line of credit	Lender: All policies
109	Insures transfer of lessor's benefits in community lease	Owner: Standard Lender: Standard
110.1	Amends policy to delete specified exception	All policies
110.3	Insures that mineral interest owner's right of surface entry has been conveyed to owner of surface	Owner: All policies Lender: All policies
110.4	Insures proper modification of deed of trust—specific provision quoted (no priority coverage)	Lender: Extended
110.5	Insures proper modification of deed of trust (express priority coverage)	Lender: Extended

110.6	Insures proper modification of deed of trust (express priority coverage)	Lender: Standard
110.7	Covers loss from enforcement of specified lien or encumbrance	Owner: All policies Lender: All policies
110.9 (ALTA 8.1)	Covers loss from lack of priority of insured residential deed of trust over environmental protection lien	Lender: Extended
110.10	Provides insurance related to modification and additional advance agreement on (1) vesting of title, (2) priority of insured deed of trust, and (3) reconveyance or modification of insured deed of trust, with qualifications	Lender: Extended
111	Covers loss of priority of lien of deed of trust on remaining secured land from partial reconveyance	Lender: All policies
111.1	Insures that, except to extent of consideration received, a partial reconveyance has not reduced policy liability for loss	Lender: All policies
111.2	Insures that subordination agreement did not impair lien of deed of trust	Lender: All policies
111.3	Covers loss from (1) impairment of lien of deed of trust on remaining land caused by partial reconveyance and (2) assurances on encroachments and designation of improvements on remaining land (combines form 111, 116 and paragraph 1(d) of form 100)	Lender: All policies
111.4	Insures lender and Housing and Urban Development of validity and priority of insured deed of trust in certain circumstances	Lender: All policies
111.5 (ALTA 6)	For variable rate mortgages, covers loss from (1) invalidity or unenforceability of insured deed of trust from variable interest rate terms or (2) loss of priority of insured deed of trust from change in interest rate	Lender: All policies

111.6 (ALTA 6.1)	For variable rate mortgages, covers loss from (1) invalidity or unenforceability of insured deed of trust from variable interest rate terms or (2) loss of priority of insured deed of trust from change in interest rate, which coverage is conditioned on compliance with specified statutes or regulations	Lender: All policies
111.7	For variable rate mortgages, covers loss from (1) invalidity or unenforceability of insured deed of trust from variable interest rate or renewal terms or (2) loss of priority of insured deed of trust from renewal or change in interest rate	Lender: All policies
111.8 (ALTA 6.2)	For variable rate mortgages, covers loss from (1) invalidity or unenforceability of insured deed of trust from changes in interest rate, addition of unpaid interest to principal and/or interest on interest, or (2) loss of priority of insured deed of trust from same	Lender: All policies
111.9	For variable rate FNMA balloon mortgage, covers loss from (1) invalidity or unenforceability of insured deed of trust from conditional right to refinance and changes in interest rate and (2) loss of priority of incurred deed of trust from exercise of conditional right to refinance and change in interest rate, with qualifications	Lender: All policies
111.10	Revolving credit loan (optional advance)—covers (1) loss from invalidity or unenforceability of insured deed of trust or (2) loss of priority of insured deed of trust for unpaid balance with interest from changes in interest rate in accordance with terms of a specified loan agreement	Lender: All policies
111.11	Revolving credit loan (obligatory advance)—covers (1) loss from invalidity or unenforceability of insured deed of trust or (2) loss of	Lender: All policies

	priority of insured deed of trust for unpaid balance with interest from changes in interest rate under terms of specified loan agreement	
112	Amends conditions and stipulations to provide coverage for bondholders if insured deed of trust is a trust indenture securing bonds	Lender: Standard
112.1	Amends conditions and stipulations to provide coverage for bondholders if insured deed of trust is trust indenture securing bonds	Lender: Extended
112.2	Amends conditions and stipulations to provide coverage for bondholders if bonds are a line on revenue produced from land	Lender: Standard
114	Provides coinsurance—segregated liability	All policies
114.1	Provides coinsurance—joint and several liability	All policies
114.2	Provides coinsurance—joint and several liability, proportioned loss	All policies
115	Insures that the estate or interest covered by policy is a condominium, entitled to be assessed and taxed as separate parcel	Owner: All policies Lender: All policies
115.1 (ALTA 4)	Condominiums—covers statutory compliance, violations of CC&Rs, homeowners' association charges and assessments, separate assessment of real property taxes, encroachments, and exercise of right of first refusal to purchase	Lender: Extended
115.2 (ALTA 5)	Planned unit development—covers violations of CC&Rs, homeowners' association charges and assessments, encroachments, and exercise of right of first refusal to purchase	Lender: Extended
116	Insures (1) accuracy of street address of designated improvements and (2) sufficiency of policy plat to	Lender: Extended

	show record location and dimensions of land	
116.1	Insures that land described in policy is same as shown on survey	Lender: All policies
116.2	Insures (1) accuracy of street address and (2) sufficiency of map or plan to show exterior boundary of condominium project	Owner: Standard Lender: All policies
116.3	Insures that land described in policy constitutes all or part of later subdivision of land	Owner: All policies Lender: All policies
116.4	Insures that land described in policy is contiguous to other land	Owner: All policies Lender: All policies
116.5 (ALTA 7)	Insures that term "land" in policy includes manufactured housing unit located on land at date of policy	Lender: All policies
116.6	Insures that term "land" in policy includes manufactured housing unit (requires description of manufactured housing unit in endorsement)	Lender: All policies
116.7	Insures that insured property is lawfully created parcel according to Subdivision Map Act and applicable local ordinances	Owner: All policies Lender: All policies
119	Insures validity of lease that has priority over insured deed of trust	Lender: All policies
119.1	Amends policy to add leasehold exceptions to Schedule B	Owner: Standard Lender: Standard
119.2	Insures validity, priority, and subsistence of lease that has priority over insured deed of trust	Lender: Extended
119.3	Insures priority of lease that has priority over insured deed of trust in situations involving circuity of lien issues—i.e., relative priority among purchase money deed of trust, lease, and permanent financing deed of trust	Lender: Extended
119.4	Insures bondholders that sublease is valid and binding at commencement of term	Lender: Standard
120.2	Insures that deed of trust is	Lessee: Oil Leasehold

	subordinate to oil and gas lease	
122	Insures priority of obligatory advance over intervening matters—liability limited to face amount of policy	Lender: All policies
122.2	Insures priority of obligatory advance over intervening matters—liability increased by amount of advance	Lender: All policies
122.3	Insures priority of obligatory advance over intervening matters—liability limited to face amount of policy	Lender: ALTA construction loan policy
122.4	Insures priority of obligatory advance over intervening matters—liability increased by amount of advance	Lender: ALTA construction loan policy
123.1 (ALTA 3)	Insures zoning classification of land and broad allowable uses under that classification (vacant land)	Owner: All policies Lender: All policies
123.2 (ALTA 3.1)	Insures zoning classification of land, broad allowable uses under that classification, and limited coverage on compliance of existing structure with applicable zoning provisions (improved land)	Owner: All policies Lender: All policies
124.1	Insures that affirmative and negative covenants in deeds or agreements (except leases) are binding	Owner: All policies Lender: All policies
124.2	Insures lessor's affirmative covenants	Lessee: All policies Lender: All policies
124.3	Insures lessor's negative covenants	Lessee: All policies Lender: All policies
125	Covers loss from *judicial* determination that insured deed of trust lien (or lender's title after foreclosure) was defeated by valid exercise of Truth in Lending Act's right of rescission that existed because there was no Regulation Z exemption	Lender: Extended
126	For owner of single-family residential property, covers specified loss from lack of right of access, mechanics' lien rights, encroachments, zoning and restrictions	Owner: All policies

	violations, and surface entry for mineral development	
126.1	For owner of one-to-four unit residence—covers specified loss from lack of right of access, mechanics' lien rights, encroachments, zoning and restrictions violations, and surface entry for mineral development	Owner: All policies
126.2	For condominium owner—covers specified loss from separate assessment of taxes, lack of right of access, mechanics' lien rights, encroachments, zoning and restrictions violations, and surface entry for mineral development	Owner: All policies
126.3	Same as CLTA 126 except no limitation on number of families	Owner: All policies

[1] Availability of endorsement for a specific policy form may vary among insurers.

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Source: Real Property/California Title Insurance Practice/Appendix O CLTA/ALTA Homeowner's Policies (1998, 2003, and 2008)

Appendix O

CLTA/ALTA Homeowner's Policies (1998, 2003, and 2008)

Homeowner's Policy of Title Insurance For a One-to-Four Family Residence

(1998)

Issued by:

Blank Title Insurance Company

Owner's Coverage Statement

This Policy insures You against actual loss, including any costs, attorneys' fees and expenses provided under this Policy, resulting from the Covered Risks set forth below, if the Land is an improved residential lot on which there is located a one-to-four family residence and each insured named in Schedule A is a Natural Person.

Your insurance is effective on the Policy Date. This Policy covers Your actual loss from any risk described under Covered Risks if the event creating the risk exists on the Policy Date or, to the extent expressly stated, after the Policy Date.

Your insurance is limited by all of the following:

The Policy Amount shown in Schedule A

For Covered Risk 14, 15, 16 and 18, Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A

Exceptions in Schedule B

Our Duty to Defend Against Legal Actions

Exclusions on page __

Conditions on page __ and __.

Covered Risks

The Covered Risks are:

1. Someone else owns an interest in Your Title.
2. Someone else has rights affecting Your Title arising out of leases, contracts, or options.
3. Someone else claims to have rights affecting Your Title arising out of forgery or impersonation.
4. Someone else has an easement on the Land.
5. Someone else has a right to limit Your use of the Land.
6. Your Title is defective.
7. Any of Covered Risks 1 through 6 occurring after the Policy Date.
8. Someone else has a lien on Your Title, including a:
   a. Mortgage;
   b. judgment, state or federal tax lien, or special assessment;
   c. charge by a homeowner's or condominium association; or
   d. lien, occurring before or after the Policy Date, for labor and material furnished before the Policy Date.
9. Someone else has an encumbrance on Your Title.
10. Someone else claims to have rights affecting Your Title arising out of fraud, duress, incompetency or incapacity.
11. You do not have both actual vehicular and pedestrian access to and from the Land, based upon a legal right.
12. You are forced to correct or remove an existing violation of any covenant, condition or restriction affecting the Land, even if the covenant, condition or restriction is excepted in Schedule B.
13. Your Title is lost or taken because of a violation of any covenant, condition or restriction, which occurred before You acquired Your Title, even if the covenant, condition or restriction is excepted in Schedule B.
14. Because of an existing violation of a subdivision law or regulation affecting the Land:
    a. You are unable to obtain a building permit;
    b. You are forced to correct or remove the violation; or
    c. Someone else has a legal right to, and does, refuse to perform a contract to purchase the Land, lease it or make a Mortgage loan on it.

    The amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.
15. You are forced to remove or remedy Your existing structures, or any part of them—other than boundary walls or fences—because any portion was built without obtaining a building permit from the proper government office. The amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.

16. You are forced to remove or remedy Your existing structures, or any part of them, because they violate an existing zoning law or zoning regulation. If You are required to remedy any portion of Your existing structures, the amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.
17. You cannot use the Land because use as a single-family residence violates an existing zoning law or zoning regulation.
18. You are forced to remove Your existing structures because they encroach onto Your neighbor's Land. If the encroaching structures are boundary walls or fences, the amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.
19. Someone else has a legal right to, and does, refuse to perform a contract to purchase the Land, lease it or make a Mortgage loan on it because Your neighbor's existing structures encroach onto the Land.
20. You are forced to remove Your existing structures because they encroach onto an easement or over a building set-back line, even if the easement or building set-back line is excepted in Schedule B.
21. Your existing structures are damaged because of the exercise of a right to maintain or use any easement affecting the Land, even if the easement is excepted in Schedule B.
22. Your existing improvements (or a replacement or modification made to them after the Policy Date), including lawns, shrubbery or trees, are damaged because of the future exercise of a right to use the surface of the Land for the extraction or development of minerals, water or any other substance, even if those rights are excepted or reserved from the description of the Land or excepted in Schedule B.
23. Someone else tries to enforce a discriminatory covenant, condition or restriction that they claim affects Your Title which is based upon race, color, religion, sex, handicap, familial status, or national origin.
24. A taxing authority assesses supplemental real estate taxes not previously assessed against the Land for any period before the Policy Date because of construction or a change of ownership or use that occurred before the Policy Date.
25. Your neighbor builds any structures after the Policy Date—other than boundary walls or fences—which encroach onto the Land.
26. Your Title is unmarketable, which allows someone else to refuse to perform a contract to purchase the Land, lease it or make a Mortgage loan on it.
27. A document upon which Your Title is based is invalid because it was not properly signed, sealed, acknowledged, delivered or recorded.
28. The residence with the address shown in Schedule A is not located on the Land at the Policy Date.
29. The map, if any, attached to this Policy does not show the correct location of the Land according to the Public Records.

Our Duty to Defend Against Legal Actions

We will defend Your Title in any legal action only as to that part of the action which is based on a Covered Risk and which is not excepted or excluded from coverage in this Policy. We will pay the costs, attorneys' fees, and expenses We incur in that defense.

We will not pay for any part of the legal action which is not based on a Covered Risk or which is excepted or excluded from coverage in this Policy.

We can end Our duty to defend Your Title under paragraph 4 of the Conditions.

This Policy is not complete without Schedules A and B.

Exclusions

In addition to the Exceptions in Schedule B, You are not insured against loss, costs, attorneys' fees, and expenses resulting from:

1. Governmental police power, and the existence or violation of any law or government regulation. This includes ordinances, laws and regulations concerning:
   a. building
   b. zoning
   c. Land use
   d. improvements on the Land
   e. Land division
   f. environmental protection

   This Exclusion does not apply to violations or the enforcement of these matters if notice of the violation or enforcement appears in the Public Records at the Policy Date.

   This Exclusion does not limit the coverage described in Covered Risk 14, 15, 16, 17 or 24.
2. The failure of Your existing structures, or any part of them, to be constructed in accordance with applicable building codes. This Exclusion does not apply to violations of building codes if notice of the violation appears in the Public Records at the Policy Date.
3. The right to take the Land by condemning it, unless:
   a. a notice of exercising the right appears in the Public Records at the Policy Date; or
   b. the taking happened before the Policy Date and is binding on You if You bought the Land without Knowing of the taking.
4. Risks:
   a. that are created, allowed, or agreed to by You, whether or not they appear in the Public Records;
   b. that are Known to You at the Policy Date, but not to Us, unless they appear in the Public Records at the Policy Date;
   c. that result in no loss to You; or
   d. that first occur after the Policy Date—this does not limit the coverage described in Covered Risk 7, 8.d, 22, 23, 24 or 25.
5. Failure to pay value for Your Title.
6. Lack of a right:
   a. to any Land outside the area specifically described and referred to in paragraph 3 of Schedule A; and
   b. in streets, alleys, or waterways that touch the Land.

This Exclusion does not limit the coverage described in Covered Risk 11 or 18.

Conditions

1. Definitions:
   a. Easement—the right of someone else to use the Land for a special purpose.
   b. Known—things about which You have actual knowledge. The words "Know" and "Knowing" have the same meaning as Known.
   c. Land—the Land or condominium unit described in paragraph 3 of Schedule A and any improvements on the Land which are real property.
   d. Mortgage—a mortgage, deed of trust, trust deed or other security instrument.
   e. Natural Person—a human being, not a commercial or legal organization or entity. Natural Person includes a trustee of a Trust even if the trustee is not a human being.
   f. Policy Date—the date and time shown in Schedule A. If the insured named in Schedule A first acquires the interest shown in Schedule A by an instrument recorded in the Public Records later than the date and time shown in Schedule A, the Policy Date is the date and time the instrument is recorded.
   g. Public Records—records that give constructive notice of matters affecting Your Title, according to the state statutes where the Land is located.
   h. Title—the ownership of Your interest in the Land, as shown in Schedule A.
   i. Trust—a living trust established by a human being for estate planning.
   j. We/Our/Us—_____ Title Insurance Company.
   k. You/Your—the insured named in Schedule A and also those identified in paragraph 2.b. of these Conditions.
2. Continuation of Coverage:
   a. This Policy insures You forever, even after You no longer have Your Title. You cannot assign this Policy to anyone else.
   b. This Policy also insures:
      (1) anyone who inherits Your Title because of Your death;
      (2) Your spouse who receives Your Title because of dissolution of Your marriage;
      (3) the trustee or successor trustee of a Trust to whom You transfer Your Title after the Policy Date; or
      (4) the beneficiaries of Your Trust upon Your death.
   c. We may assert against the insureds identified in paragraph 2.b. any rights and defenses that We have against any previous insured under this Policy.
3. How to Make a Claim
   a. Prompt Notice of Your Claim
      (1) As soon as You Know of anything that might be covered by this Policy, You must notify Us promptly in writing.
      (2) Send Your notice to *Blank Title Insurance Company*, _____, Attention: Claims Department. Please include the Policy number shown in Schedule A, and the county and state where the Land is located. Please enclose a copy of Your policy, if available.
      (3) If You do not give Us prompt notice, Your coverage will be reduced or ended, but only to the extent Your failure affects Our ability to resolve the claim or defend You.
   b. Proof of Your Loss
      (1) We may require You to give Us a written statement signed by You describing Your loss which includes:
         (a) the basis of Your claim;
         (b) the Covered Risks which resulted in Your loss;
         (c) the dollar amount of Your loss; and
         (d) the method You used to compute the amount of Your loss.
      (2) We may require You to make available to Us records, checks, letters, contracts, insurance policies and other papers which relate to Your claim. We may make copies of these papers.
      (3) We may require You to answer questions about Your claim under oath.
      (4) If You fail or refuse to give Us a statement of loss, answer Our questions under oath, or make available to Us the papers We request, Your coverage will be reduced or ended, but only to the extent Your failure or refusal affects Our ability to resolve the claim or defend You.
4. Our Choices When We Learn of a Claim
   a. After We receive Your notice, or otherwise learn, of a claim that is covered by this Policy, Our choices include one or more of the following:
      (1) Pay the claim.
      (2) Negotiate a settlement.
      (3) Bring or defend a legal action related to the claim.
      (4) Pay You the amount required by this Policy.
      (5) End the coverage of this Policy for the claim by paying You Your actual loss resulting from the Covered Risk, and those costs, attorneys' fees and expenses incurred up to that time which We are obligated to pay.
      (6) End the coverage described in Covered Risk 14, 15, 16 or 18 by paying You the amount of Your insurance then in force for the particular Covered Risk, and those costs, attorneys' fees and expenses incurred up to that time which We are obligated to pay.
      (7) End all coverage of this Policy by paying You the Policy Amount then in force, and all those costs, attorneys' fees and expenses incurred up to that time which We are obligated to pay.

(8) Take other appropriate action.

b. When We choose the options in paragraphs 4.a. (5), (6) or (7), all Our obligations for the claim end, including Our obligation to defend, or continue to defend, any legal action.

c. Even if We do not think that the Policy covers the claim, We may choose one or more of the options above. By doing so, We do not give up any rights.

5. Handling a Claim or Legal Action

a. You must cooperate with Us in handling any claim or legal action and give Us all relevant information.

b. If You fail or refuse to cooperate with Us, Your coverage will be reduced or ended, but only to the extent Your failure or refusal affects Our ability to resolve the claim or defend You.

c. We are required to repay You only for those settlement costs, attorneys' fees and expenses that We approve in advance.

d. We have the right to choose the attorney when We bring or defend a legal action on Your behalf. We can appeal any decision to the highest level. We do not have to pay Your claim until the legal action is finally decided.

e. Whether or not We agree there is coverage, We can bring or defend a legal action, or take other appropriate action under this Policy. By doing so, We do not give up any rights.

6. Limitation of Our Liability

a. After subtracting Your Deductible Amount if it applies, We will pay no more than the least of:

(1) Your actual loss;

(2) Our Maximum Dollar Limit of Liability then in force for the particular Covered Risk, for claims covered only under Covered Risk 14, 15, 16 or 18; or

(3) the Policy Amount then in force;

and any costs, attorneys' fees and expenses which We are obligated to pay under this Policy.

b. (1) If We remove the cause of the claim with reasonable diligence after receiving notice of it, all Our obligations for the claim end, including any obligation for loss You had while We were removing the cause of the claim.

(2) Regardless of 6.b. (1) above, if You cannot use the Land because of a claim covered by this Policy:

(a) You may rent a reasonably equivalent substitute residence and We will repay You for the actual rent You pay, until the earlier of:

(1) the cause of the claim is removed; or

(2) We pay You the amount required by this Policy. If Your claim is covered only under Covered Risk 14, 15, 16 or 18, that payment is the amount of Your insurance then in force for the particular Covered Risk.

(b) We will pay reasonable costs You pay to relocate any personal property You have the right to remove from the Land, including transportation of that personal property for up to twenty-five (25) miles from the Land, and repair of any damage to that personal property because of the relocation. The amount We will pay You under this paragraph is limited to the value of the personal property before You relocate it.

c. All payments We make under this Policy reduce the Policy Amount, except for costs, attorneys' fees and expenses. All payments we make for claims which are covered only under Covered Risk 14, 15, 16 or 18 also reduce Our Maximum Dollar Limit of Liability for the particular Covered Risk, except for costs, attorneys' fees and expenses.

d. If We issue, or have issued, a Policy to the owner of a Mortgage on Your Title and We have not given You any coverage against the Mortgage, then:

(1) We have the right to pay any amount due You under this Policy to the owner of the Mortgage to reduce the amount of the Mortgage, and any amount paid shall be treated as a payment to You under this Policy, including under paragraph 4.a. of these Conditions;

(2) Any amount paid to the owner of the Mortgage shall be subtracted from the Policy Amount of this Policy; and

(3) If Your claim is covered only under Covered Risk 14, 15, 16 or 18, any amount paid to the owner of the Mortgage shall also be subtracted from Our Maximum Dollar Limit of Liability for the particular Covered Risk.

e. If You do anything to affect any right of recovery You may have against someone else, We can subtract from Our liability the amount by which You reduced the value of that right.

7. Transfer of Your Rights to Us

a. When We settle Your claim, We have all the rights You have against any person or property related to the claim. You must transfer these rights to Us when We ask, and You must not do anything to affect these rights. You must let Us use Your name in enforcing these rights.

b. We will not be liable to You if We do not pursue these rights or if We do not recover any amount that might be recoverable.

c. We will pay any money We collect from enforcing these rights in the following order:

(1) to Us for the costs, attorneys' fees and expenses We paid to enforce these rights;

(2) to You for Your loss that You have not already collected;

(3) to Us for any money We paid out under this Policy on account of Your claim; and

(4) to You whatever is left.

d. If You have rights under contracts (such as indemnities, guaranties, bonds or other policies of insurance) to recover all or part of Your loss, then We have all of those rights, even if those contracts provide that those obligated have all of Your rights under this Policy.

8. Entire Contract

This Policy, with any endorsements, is the entire contract between You and Us. To determine the meaning of any part of this Policy, You must read the entire Policy. Any changes to this Policy must be agreed to in writing by Us. Any claim You make against Us must be made under this Policy and is subject to its terms.

9. Increased Policy Amount

   The Policy Amount will increase by ten percent (10%) of the Policy Amount shown in Schedule A each year for the first five years following the Policy Date shown in Schedule A, up to one hundred fifty percent (150%) of the Policy Amount shown in Schedule A. The increase each year will happen on the anniversary of the Policy Date shown in Schedule A.

10. Severability

    If any part of this Policy is held to be legally unenforceable, both You and We can still enforce the rest of this Policy.

11. Arbitration

    a. If permitted in the state where the Land is located You or We may demand arbitration.

    b. The arbitration shall be binding on both You and Us. The arbitration shall decide any matter in dispute between You and Us.

    c. The arbitration award may be entered as a judgment in the proper court.

    d. The arbitration shall be under the Title Insurance Arbitration Rules of the American Arbitration Association. You may choose current Rules or Rules in existence on Policy Date.

    e. The law used in the arbitration is the law of the place where the Land is located.

    f. You can get a copy of the Rules from Us.

CLTA Homeowner's Policy of Title Insurance (6/2/98)

ALTA Homeowner's Policy of Title Insurance (10/17/98)

Owner's Information Sheet

Blank Title Insurance Company

Homeowner's Policy of Title Insurance For a One-to-Four Family Residence

(1998)

Owner's Information Sheet

Your Title Insurance Policy is a legal contract between You and Us.

It applies only to a one-to-four family residence and only if each insured named in Schedule A is a Natural Person. If the Land described in Schedule A of the Policy is not an improved residential lot on which there is located a one-to-four family residence, or if each insured named in Schedule A is not a Natural Person, contact Us immediately.

The Policy insures You against actual loss resulting from certain Covered Risks. These Covered Risks are listed beginning on page __ of the Policy. The Policy is limited by:

Provisions of Schedule A

Exceptions in Schedule B

Our Duty to Defend Against Legal Actions on page _____

Exclusions on page __

Conditions on pages __ and __.

You should keep the Policy even if You transfer Your Title to the Land.

If You want to make a claim, see paragraph 3 under Conditions on page __.

You do not owe any more premiums for the Policy.

This sheet is not Your insurance Policy. It is only a brief outline of some of the important Policy features. The Policy explains in detail Your rights and obligations and Our rights and obligations. Since the Policy—and not this sheet—is the legal document,

YOU SHOULD READ THE POLICY VERY CAREFULLY.

If You have any questions about Your Policy, contact:

Blank Title Insurance Company

_____

_____

_____

CLTA Homeowner's Policy of Title Insurance (6/2/98)

ALTA Homeowner's Policy of Title Insurance (10/17/98)

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Blank Title Insurance Company

Homeowner's Policy of Title Insurance
For a One-to-Four Family Residence

(1998)

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Deductible Amounts and Maximum Dollar Limits of Liability ____
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2. Interest in Land Covered ____
3. Description of the Land ____
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CLTA Homeowner's Policy of Title Insurance (6/2/98)
ALTA Homeowner's Policy of Title Insurance (10/17/98)
Schedule A

SCHEDULE A

(1998)

Policy No.: _____ Premium: $_____
Policy Amount: $ _____ Policy Date [and Time]:_____

Deductible Amounts and Maximum Dollar Limits of Liability For Covered Risks 14, 15, 16 and 18:

	Your Deductible Amount	Our Maximum Dollar Limit of Liability
Covered Risk 14:	__% of Policy Amount or $_____ (whichever is less)	$_____
Covered Risk 15:	__% of Policy Amount or $_____ (whichever is less)	$_____
Covered Risk 16:	__% of Policy Amount or $_____ (whichever is less)	$_____
Covered Risk 18:	__% of Policy Amount or $_____ (whichever is less)	$_____

Street Address of the Land:

1. Name of insured:
2. Your interest in the Land covered by this Policy is:
3. The Land referred to in this Policy is described as:

CLTA Homeowner's Policy of Title Insurance (6/2/98)
ALTA Homeowner's Policy of Title Insurance (10/17/98)
Schedule B

SCHEDULE B

(1998)

Exceptions

In addition to the Exclusions, You are not insured against loss, costs, attorneys' fees, and expenses resulting from:

Homeowner's Policy of Title Insurance
For a One-to-Four Family Residence

(2003)

Issued by:

Blank Title Insurance Company

Owner's Coverage Statement

This Policy insures You against actual loss, including any costs, attorneys' fees and expenses provided under this Policy, resulting from the Covered Risks set forth below, if the Land is an improved residential lot on which there is located a one-to-four family residence and each insured named in Schedule A is a Natural Person.

Your insurance is effective on the Policy Date. This Policy covers Your actual loss from any risk described under Covered Risks if the event creating the risk exists on the Policy Date or, to the extent expressly stated, after the Policy Date.

Your insurance is limited by all of the following:

The Policy Amount shown in Schedule A

For Covered Risk 14, 15, 16 and 18, Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A

Exceptions in Schedule B

Our Duty To Defend Against Legal Actions

Exclusions on page _____

Conditions on page _____ and _____.

Covered Risks

The Covered Risks are:

1. Someone else owns an interest in Your Title.
2. Someone else has rights affecting Your Title arising out of leases, contracts, or options.
3. Someone else claims to have rights affecting Your Title arising out of forgery or impersonation.
4. Someone else has an easement on the Land.
5. Someone else has a right to limit Your use of the Land.
6. Your Title is defective.
7. Any of Covered Risks 1 through 6 occurring after the Policy Date.
8. Someone else has a lien on Your Title, including a:
   a. Mortgage;
   b. judgment, state or federal tax lien, or special assessment;
   c. charge by a homeowner's or condominium association; or
   d. lien, occurring before or after the Policy Date, for labor and material furnished before the Policy Date.
9. Someone else has an encumbrance on Your Title.
10. Someone else claims to have rights affecting Your Title arising out of fraud, duress, incompetency or incapacity.
11. You do not have both actual vehicular and pedestrian access to and from the Land, based upon a legal right.
12. You are forced to correct or remove an existing violation of any covenant, condition or restriction affecting the Land, even if the covenant, condition or restriction is excepted in Schedule B. However, you are not covered for any violation that relates to any obligation to perform maintenance or repair on the Land, or relates to environmental protection of any kind or nature, including hazardous or toxic conditions or substances, unless notice of the violation is recorded in the Public Records.
13. Your Title is lost or taken because of a violation of any covenant, condition or restriction, which occurred before You acquired Your Title, even if the covenant, condition or restriction is excepted in Schedule B.
14. Because of an existing violation of a subdivision law or regulation affecting the Land:
    a. You are unable to obtain a building permit;
    b. You are forced to correct or remove the violation; or
    c. someone else has a legal right to, and does, refuse to perform a contract to purchase the Land, lease it or make a Mortgage loan on it.

    The amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.
15. You are forced to remove or remedy Your existing structures, or any part of them—other than boundary walls or fences—because any portion was built without obtaining a building permit from the proper government office. The amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.
16. You are forced to remove or remedy Your existing structures, or any part of them, because they violate an existing zoning law or zoning

regulation. If You are required to remedy any portion of Your existing structures, the amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.

17. You cannot use the Land because use as a single-family residence violates an existing zoning law or zoning regulation.
18. You are forced to remove Your existing structures because they encroach onto Your neighbor's land. If the encroaching structures are boundary walls or fences, the amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.
19. Someone else has a legal right to, and does, refuse to perform a contract to purchase the Land, lease it or make a Mortgage loan on it because Your neighbor's existing structures encroach onto the Land.
20. You are forced to remove Your existing structures because they encroach onto an easement or over a building set-back line, even if the easement or building set-back line is excepted in Schedule B.
21. Your existing structures are damaged because of the exercise of a right to maintain or use any easement affecting the Land, even if the easement is excepted in Schedule B.
22. Your existing improvements (or a replacement or modification made to them after the Policy Date), including lawns, shrubbery or trees, are damaged because of the future exercise of a right to use the surface of the Land for the extraction or development of minerals, water or any other substance, even if those rights are excepted or reserved from the description of the Land or excepted in Schedule B.
23. Someone else tries to enforce a discriminatory covenant, condition or restriction that they claim affects Your Title which is based upon race, color, religion, sex, handicap, familial status, or national origin.
24. A taxing authority assesses supplemental real estate taxes not previously assessed against the Land for any period before the Policy Date because of construction or a change of ownership or use that occurred before the Policy Date.
25. Your neighbor builds any structures after the Policy Date—other than boundary walls or fences—which encroach onto the Land.
26. Your Title is unmarketable, which allows someone else to refuse to perform a contract to purchase the Land, lease it or make a Mortgage loan on it.
27. A document upon which Your Title is based is invalid because it was not properly signed, sealed, acknowledged, delivered or recorded.
28. The residence with the address shown in Schedule A is not located on the Land at the Policy Date.
29. The map, if any, attached to this Policy does not show the correct location of the Land according to the Public Records.

Our Duty To Defend Against Legal Actions

We will defend Your Title in any legal action only as to that part of the action which is based on a Covered Risk and which is not excepted or excluded from coverage in this Policy. We will pay the costs, attorneys' fees, and expenses We incur in that defense.

We will not pay for any part of the legal action which is not based on a Covered Risk or which is excepted or excluded from coverage in this Policy.

We can end Our duty to defend Your Title under paragraph 4 of the Conditions.

This Policy is not complete without Schedules A and B.

Exclusions

In addition to the Exceptions in Schedule B, You are not insured against loss, costs, attorneys' fees, and expenses resulting from:

1. Governmental police power, and the existence or violation of any law or government regulation. This includes ordinances, laws and regulations concerning:
   a. building;
   b. zoning;
   c. Land use;
   d. improvements on the Land;
   e. Land division;
   f. environmental protection.

   This Exclusion does not apply to violations or the enforcement of these matters if notice of the violation or enforcement appears in the Public Records at the Policy Date.

   This Exclusion does not limit the coverage described in Covered Risk 14, 15, 16, 17 or 24.
2. The failure of Your existing structures, or any part of them, to be constructed in accordance with applicable building codes. This Exclusion does not apply to violations of building codes if notice of the violation appears in the Public Records at the Policy Date.
3. The right to take the Land by condemning it, unless:
   a. a notice of exercising the right appears in the Public Records at the Policy Date; or
   b. the taking happened before the Policy Date and is binding on You if You bought the Land without Knowing of the taking.
4. Risks:
   a. that are created, allowed, or agreed to by You, whether or not they appear in the Public Records;
   b. that are Known to You at the Policy Date, but not to Us, unless they appear in the Public Records at the Policy Date;
   c. that result in no loss to You; or
   d. that first occur after the Policy Date—this does not limit the coverage described in Covered Risk 7, 8.d, 22, 23, 24 or 25.
5. Failure to pay value for Your Title.
6. Lack of a right:
   a. to any land outside the area specifically described and referred to in paragraph 3 of Schedule A; and
   b. in streets, alleys, or waterways that touch the Land.

   This Exclusion does not limit the coverage described in Covered Risk 11 or 18.

Conditions

1. Definitions:
   a. Easement—the right of someone else to use the Land for a special purpose.
   b. Known—things about which You have actual knowledge. The words "Know" and "Knowing" have the same meaning as Known.
   c. Land—the Land or condominium unit described in paragraph 3 of Schedule A and any improvements on the Land which are real property.
   d. Mortgage—a mortgage, deed of trust, trust deed or other security instrument.
   e. Natural Person—a human being, not a commercial or legal organization or entity. Natural Person includes a trustee of a Trust even if the trustee is not a human being.
   f. Policy Date—the date and time shown in Schedule A. If the insured named in Schedule A first acquires the interest shown in Schedule A by an instrument recorded in the Public Records later than the date and time shown in Schedule A, the Policy Date is the date and time the instrument is recorded.
   g. Public Records—records that give constructive notice of matters affecting Your Title, according to the state statutes where the Land is located.
   h. Title—the ownership of Your interest in the Land, as shown in Schedule A.
   i. Trust—a living trust established by a human being for estate planning.
   j. We/Our/Us—Blank Title Insurance Company.
   k. You/Your—the insured named in Schedule A and also those identified in paragraph 2.b. of these Conditions.
2. Continuation of Coverage:
   a. This Policy insures You forever, even after You no longer have Your Title. You cannot assign this Policy to anyone else.
   b. This Policy also insures:
      (1) anyone who inherits Your Title because of Your death;
      (2) Your spouse who receives Your Title because of dissolution of Your marriage;
      (3) the trustee or successor trustee of a Trust to whom You transfer Your Title after the Policy Date; or
      (4) the beneficiaries of Your Trust upon Your death.
   c. We may assert against the insureds identified in paragraph 2.b. any rights and defenses that We have against any previous insured under this Policy.
3. How To Make A Claim
   a. Prompt Notice Of Your Claim
      (1) As soon as You Know of anything that might be covered by this Policy, You must notify Us promptly in writing.
      (2) Send Your notice to Blank Title Insurance Company, Attention: Claims Department. Please include the Policy number shown in Schedule A, and the county and state where the Land is located. Please enclose a copy of Your policy, if available.
      (3) If You do not give Us prompt notice, Your coverage will be reduced or ended, but only to the extent Your failure affects Our ability to resolve the claim or defend You.
   b. Proof Of Your Loss
      (1) We may require You to give Us a written statement signed by You describing Your loss which includes:
         (a) the basis of Your claim;
         (b) the Covered Risks which resulted in Your loss;
         (c) the dollar amount of Your loss; and
         (d) the method You used to compute the amount of Your loss.
      (2) We may require You to make available to Us records, checks, letters, contracts, insurance policies and other papers which relate to Your claim. We may make copies of these papers.
      (3) We may require You to answer questions about Your claim under oath.
      (4) If You fail or refuse to give Us a statement of loss, answer Our questions under oath, or make available to Us the papers We request, Your coverage will be reduced or ended, but only to the extent Your failure or refusal affects Our ability to resolve the claim or defend You.
4. Our Choices When We Learn Of A Claim
   a. After We receive Your notice, or otherwise learn, of a claim that is covered by this Policy, Our choices include one or more of the following:
      (1) Pay the claim.
      (2) Negotiate a settlement.
      (3) Bring or defend a legal action related to the claim.
      (4) Pay You the amount required by this Policy.
      (5) End the coverage of this Policy for the claim by paying You Your actual loss resulting from the Covered Risk, and those costs, attorneys' fees and expenses incurred up to that time which We are obligated to pay.
      (6) End the coverage described in Covered Risk 14, 15, 16 or 18 by paying You the amount of Your insurance then in force for the particular Covered Risk, and those costs, attorneys' fees and expenses incurred up to that time which We are obligated to pay.
      (7) End all coverage of this Policy by paying You the Policy Amount then in force, and all those costs, attorneys' fees and expenses incurred up to that time which We are obligated to pay.
      (8) Take other appropriate action.

b. When We choose the options in paragraphs 4.a. (5), (6) or (7), all Our obligations for the claim end, including Our obligation to defend, or continue to defend, any legal action.

c. Even if We do not think that the Policy covers the claim, We may choose one or more of the options above. By doing so, We do not give up any rights.

5. Handling A Claim Or Legal Action

a. You must cooperate with Us in handling any claim or legal action and give Us all relevant information.

b. If You fail or refuse to cooperate with Us, Your coverage will be reduced or ended, but only to the extent Your failure or refusal affects Our ability to resolve the claim or defend You.

c. We are required to repay You only for those settlement costs, attorneys' fees and expenses that We approve in advance.

d. We have the right to choose the attorney when We bring or defend a legal action on Your behalf. We can appeal any decision to the highest level. We do not have to pay Your claim until the legal action is finally decided.

e. Whether or not We agree there is coverage, We can bring or defend a legal action, or take other appropriate action under this Policy. By doing so, We do not give up any rights.

6. Limitation Of Our Liability

a. After subtracting Your Deductible Amount if it applies, We will pay no more than the least of:

(1) Your actual loss;

(2) Our Maximum Dollar Limit of Liability then in force for the particular Covered Risk, for claims covered only under Covered Risk 14, 15, 16 or 18; or

(3) the Policy Amount then in force;

and any costs, attorneys' fees and expenses which We are obligated to pay under this Policy.

b. (1) If We remove the cause of the claim with reasonable diligence after receiving notice of it, all Our obligations for the claim end, including any obligation for loss You had while We were removing the cause of the claim.

(2) Regardless of 6.b. (1) above, if You cannot use the Land because of a claim covered by this Policy:

(a) You may rent a reasonably equivalent substitute residence and We will repay You for the actual rent You pay, until the earlier of:

(1) the cause of the claim is removed; or

(2) We pay You the amount required by this Policy. If Your claim is covered only under Covered Risk 14, 15, 16 or 18, that payment is the amount of Your insurance then in force for the particular Covered Risk.

(b) We will pay reasonable costs You pay to relocate any personal property You have the right to remove from the Land, including transportation of that personal property for up to twenty-five (25) miles from the Land, and repair of any damage to that personal property because of the relocation. The amount We will pay You under this paragraph is limited to the value of the personal property before You relocate it.

c. All payments We make under this Policy reduce the Policy Amount, except for costs, attorneys' fees and expenses. All payments we make for claims which are covered only under Covered Risk 14, 15, 16 or 18 also reduce Our Maximum Dollar Limit of Liability for the particular Covered Risk, except for costs, attorneys' fees and expenses.

d. If We issue, or have issued, a Policy to the owner of a Mortgage on Your Title and We have not given You any coverage against the Mortgage, then:

(1) We have the right to pay any amount due You under this Policy to the owner of the Mortgage to reduce the amount of the Mortgage, and any amount paid shall be treated as a payment to You under this Policy, including under paragraph 4.a. of these Conditions;

(2) Any amount paid to the owner of the Mortgage shall be subtracted from the Policy Amount of this Policy; and

(3) If Your claim is covered only under Covered Risk 14, 15, 16 or 18, any amount paid to the owner of the Mortgage shall also be subtracted from Our Maximum Dollar Limit of Liability for the particular Covered Risk.

e. If You do anything to affect any right of recovery You may have against someone else, We can subtract from Our liability the amount by which You reduced the value of that right.

7. Transfer Of Your Rights To Us

a. When We settle Your claim, We have all the rights You have against any person or property related to the claim. You must transfer these rights to Us when We ask, and You must not do anything to affect these rights. You must let Us use Your name in enforcing these rights.

b. We will not be liable to You if We do not pursue these rights or if We do not recover any amount that might be recoverable.

c. We will pay any money We collect from enforcing these rights in the following order:

(1) to Us for the costs, attorneys' fees and expenses We paid to enforce these rights;

(2) to You for Your loss that You have not already collected;

(3) to Us for any money We paid out under this Policy on account of Your claim; and

(4) to You whatever is left.

d. If You have rights under contracts (such as indemnities, guaranties, bonds or other policies of insurance) to recover all or part of Your loss, then We have all of those rights, even if those contracts provide that those obligated have all of Your rights under this Policy.

8. Entire Contract

This Policy, with any endorsements, is the entire contract between You and Us. To determine the meaning of any part of this Policy, You must read the entire Policy. Any changes to this Policy must be agreed to in writing by Us. Any claim You make against Us must be made under this Policy and is subject to its terms.

9. Increased Policy Amount

The Policy Amount will increase by ten percent (10%) of the Policy Amount shown in Schedule A each year for the first five years following the Policy Date shown in Schedule A, up to one hundred fifty percent (150%) of the Policy Amount shown in Schedule A. The increase each year will happen on the anniversary of the Policy Date shown in Schedule A.

10. Severability

    If any part of this Policy is held to be legally unenforceable, both You and We can still enforce the rest of this Policy.

11. Arbitration

    a. If permitted in the state where the Land is located, You or We may demand arbitration.
    b. The arbitration shall be binding on both You and Us. The arbitration shall decide any matter in dispute between You and Us.
    c. The arbitration award may be entered as a judgment in the proper court.
    d. The arbitration shall be under the Title Insurance Arbitration Rules of the American Arbitration Association. You may choose current Rules or Rules in existence on Policy Date.
    e. The law used in the arbitration is the law of the place where the Land is located.
    f. You can get a copy of the Rules from Us.

CLTA Homeowner's Policy of Title Insurance (10/22/03)

ALTA Homeowner's Policy of Title Insurance (10/22/03)

Owner's Information Sheet

Blank Title Insurance Company

Homeowner's Policy of Title Insurance For a One-to-Four Family Residence

(2003)

Owner's Information Sheet

Your Title Insurance Policy is a legal contract between You and Us.

It applies only to a one-to-four family residence and only if each insured named in Schedule A is a Natural Person. If the Land described in Schedule A of the Policy is not an improved residential lot on which there is located a one-to-four family residence, or if each insured named in Schedule A is not a Natural Person, contact Us immediately.

The Policy insures You against actual loss resulting from certain Covered Risks. These Covered Risks are listed beginning on page ____ of the Policy. The Policy is limited by:

Provisions of Schedule A

Exceptions in Schedule B

Our Duty To Defend Against Legal Actions On page ____

Exclusions on page ___

Conditions on pages ___ and ___.

You should keep the Policy even if You transfer Your Title to the Land.

If You want to make a claim, see paragraph 3 under Conditions on page __.

You do not owe any more premiums for the Policy.

This sheet is not Your insurance Policy. It is only a brief outline of some of the important Policy features. The Policy explains in detail Your rights and obligations and Our rights and obligations. Since the Policy—and not this sheet—is the legal document,

YOU SHOULD READ THE POLICY VERY CAREFULLY.

If You have any questions about Your Policy, contact:

Blank Title Insurance Company

_____
_____
_____

CLTA Homeowner's Policy of Title Insurance (10/22/03)

ALTA Homeowner's Policy of Title Insurance (10/22/03)

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Blank Title Insurance Company

Homeowner's Policy of Title Insurance
For a One-to-Four Family Residence

(2003)

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CLTA Homeowner's Policy of Title Insurance (10/22/03)
ALTA Homeowner's Policy of Title Insurance (10/22/03)
Schedule A

SCHEDULE A

(2003)

Policy No.: _____ Premium: $ _____
Policy Amount: $ _____ Policy Date [and Time]: _____

Deductible Amounts and Maximum Dollar Limits of Liability
For Covered Risks 14, 15, 16 and 18:

	Your Deductible Amount	Our Maximum Dollar Limit of Liability
Covered Risk 14:	__% of Policy Amount or $_____ (whichever is less)	$_____
Covered Risk 15:	__% of Policy Amount or $_____ (whichever is less)	$_____
Covered Risk 16:	__% of Policy Amount or $_____ (whichever is less)	$_____
Covered Risk 18:	__% of Policy Amount or $_____ (whichever is less)	$_____

Street Address of the Land:

1. Name of insured:
2. Your interest in the Land covered by this Policy is:
3. The Land referred to in this Policy is described as:

CLTA Homeowner's Policy of Title Insurance (10/22/03)
ALTA Homeowner's Policy of Title Insurance (10/22/03)
Schedule B

SCHEDULE B

(2003)

Exceptions

In addition to the Exclusions, You are not insured against loss, costs, attorneys' fees, and expenses resulting from:

Homeowner's Policy of Title Insurance
For a One-to-Four Family Residence

(2008)

Issued by:

BLANK TITLE INSURANCE COMPANY

Owner's Coverage Statement

As soon as You Know of anything that might be covered by this Policy, You must notify Us promptly in writing at the address shown in Section 3 of the Conditions.

OWNER'S COVERAGE STATEMENT

This Policy insures You against actual loss, including any costs, attorneys' fees and expenses provided under this Policy. The loss must result from one or more of the Covered Risks set forth below. This Policy covers only Land that is an improved residential lot on which there is located a one-to-four family residence and only when each insured named in Schedule A is a Natural Person.

Your insurance is effective on the Policy Date. This Policy covers Your actual loss from any risk described under Covered Risks if the event creating the risk exists on the Policy Date or, to the extent expressly stated in Covered Risks, after the Policy Date.

Your insurance is limited by all of the following:

The Policy Amount

For Covered Risk 16, 18, 19 and 21, Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A

The Exceptions in Schedule B

Our Duty To Defend Against Legal Actions

The Exclusions on page ____.

The Conditions on pages _____ and _____.

COVERED RISKS

The Covered Risks are:

1. Someone else owns an interest in Your Title.
2. Someone else has rights affecting Your Title because of leases, contracts, or options.
3. Someone else claims to have rights affecting Your Title because of forgery or impersonation.
4. Someone else has an easement on the Land.
5. Someone else has a right to limit Your use of the Land.
6. Your Title is defective. Some of these defects are:
   a. Someone else's failure to have authorized a transfer or conveyance of your Title.
   b. Someone else's failure to create a valid document by electronic means.
   c. A document upon which Your Title is based is invalid because it was not properly signed, sealed, acknowledged, delivered or recorded.
   d. A document upon which Your Title is based was signed using a falsified, expired, or otherwise invalid power of attorney.
   e. A document upon which Your Title is based was not properly filed, recorded, or indexed in the Public Records.
   f. A defective judicial or administrative proceeding.
7. Any of Covered Risks 1 through 6 occurring after the Policy Date.
8. Someone else has a lien on Your Title, including a:
   a. lien of real estate taxes or assessments imposed on Your Title by a governmental authority that are due or payable, but unpaid;
   b. Mortgage;
   c. judgment, state or federal tax lien;
   d. charge by a homeowner's or condominium association; or
   e. lien, occurring before or after the Policy Date, for labor and material furnished before the Policy Date.
9. Someone else has an encumbrance on Your Title.
10. Someone else claims to have rights affecting Your Title because of fraud, duress, incompetency or incapacity.
11. You do not have actual vehicular and pedestrian access to and from the Land, based upon a legal right.
12. You are forced to correct or remove an existing violation of any covenant, condition or restriction affecting the Land, even if the covenant, condition or restriction is excepted in Schedule B. However, You are not covered for any violation that relates to:
    a. any obligation to perform maintenance or repair on the Land; or
    b. environmental protection of any kind, including hazardous or toxic conditions or substances

    unless there is a notice recorded in the Public Records, describing any part of the Land, claiming a violation exists. Our liability for this Covered Risk is limited to the extent of the violation stated in that notice.

13. Your Title is lost or taken because of a violation of any covenant, condition or restriction, which occurred before You acquired Your Title, even if the covenant, condition or restriction is excepted in Schedule B.
14. The violation or enforcement of those portions of any law or government regulation concerning:
    a. building;
    b. zoning;
    c. land use;
    d. improvements on the Land;
    e. land division; or
    f. environmental protection,

    if there is a notice recorded in the Public Records, describing any part of the Land, claiming a violation exists or declaring the intention to enforce the law or regulation. Our liability for this Covered Risk is limited to the extent of the violation or enforcement stated in that notice.
15. An enforcement action based on the exercise of a governmental police power not covered by Covered Risk 14 if there is a notice recorded in the Public Records, describing any part of the Land, of the enforcement action or intention to bring an enforcement action. Our liability for this Covered Risk is limited to the extent of the enforcement action stated in that notice.
16. Because of an existing violation of a subdivision law or regulation affecting the Land:
    a. You are unable to obtain a building permit;
    b. You are required to correct or remove the violation; or
    c. someone else has a legal right to, and does, refuse to perform a contract to purchase the Land, lease it or make a Mortgage loan on it.

    The amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.
17. You lose Your Title to any part of the Land because of the right to take the Land by condemning it, if:
    a. there is a notice of the exercise of the right recorded in the Public Records and the notice describes any part of the Land; or
    b. the taking happened before the Policy Date and is binding on You if You bought the Land without Knowing of the taking.
18. You are forced to remove or remedy Your existing structures, or any part of them—other than boundary walls or fences—because any portion was built without obtaining a building permit from the proper government office. The amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.
19. You are forced to remove or remedy Your existing structures, or any part of them, because they violate an existing zoning law or zoning regulation. If You are required to remedy any portion of Your existing structures, the amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.
20. You cannot use the Land because use as a single-family residence violates an existing zoning law or zoning regulation.
21. You are forced to remove Your existing structures because they encroach onto Your neighbor's land. If the encroaching structures are boundary walls or fences, the amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.
22. Someone else has a legal right to, and does, refuse to perform a contract to purchase the Land, lease it or make a Mortgage loan on it because Your neighbor's existing structures encroach onto the Land.
23. You are forced to remove Your existing structures which encroach onto an easement or over a building set-back line, even if the easement or building set-back line is excepted in Schedule B.
24. Your existing structures are damaged because of the exercise of a right to maintain or use any easement affecting the Land, even if the easement is excepted in Schedule B.
25. Your existing improvements (or a replacement or modification made to them after the Policy Date), including lawns, shrubbery or trees, are damaged because of the future exercise of a right to use the surface of the Land for the extraction or development of minerals, water or any other substance, even if those rights are excepted or reserved from the description of the Land or excepted in Schedule B.
26. Someone else tries to enforce a discriminatory covenant, condition or restriction that they claim affects Your Title which is based upon race, color, religion, sex, handicap, familial status, or national origin.
27. A taxing authority assesses supplemental real estate taxes not previously assessed against the Land for any period before the Policy Date because of construction or a change of ownership or use that occurred before the Policy Date.
28. Your neighbor builds any structures after the Policy Date—other than boundary walls or fences—which encroach onto the Land.
29. Your Title is unmarketable, which allows someone else to refuse to perform a contract to purchase the Land, lease it or make a Mortgage loan on it.
30. Someone else owns an interest in Your Title because a court order invalidates a prior transfer of the title under federal bankruptcy, state insolvency, or similar creditors' rights laws.
31. The residence with the address shown in Schedule A is not located on the Land at the Policy Date.
32. The map, if any, attached to this Policy does not show the correct location of the Land according to the Public Records.

OUR DUTY TO DEFEND AGAINST LEGAL ACTIONS

We will defend Your Title in any legal action only as to that part of the action which is based on a Covered Risk and which is not excepted or excluded from coverage in this Policy. We will pay the costs, attorneys' fees, and expenses We incur in that defense.

We will not pay for any part of the legal action which is not based on a Covered Risk or which is excepted or excluded from coverage in this Policy.

We can end Our duty to defend Your Title under Section 4 of the Conditions.

THIS POLICY IS NOT COMPLETE WITHOUT SCHEDULES A AND B.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY
BY: _____
PRESIDENT
BY: _____
SECRETARY

EXCLUSIONS

In addition to the Exceptions in Schedule B, You are not insured against loss, costs, attorneys' fees, and expenses resulting from:

1. Governmental police power, and the existence or violation of those portions of any law or government regulation concerning:
   a. building;
   b. zoning;
   c. land use;
   d. improvements on the Land;
   e. land division; and
   f. environmental protection.

   This Exclusion does not limit the coverage described in Covered Risk 8.a., 14, 15, 16, 18, 19, 20, 23 or 27.
2. The failure of Your existing structures, or any part of them, to be constructed in accordance with applicable building codes. This Exclusion does not limit the coverage described in Covered Risk 14 or 15.
3. The right to take the Land by condemning it. This Exclusion does not limit the coverage described in Covered Risk 17.
4. Risks:
   a. that are created, allowed, or agreed to by You, whether or not they are recorded in the Public Records;
   b. that are Known to You at the Policy Date, but not to Us, unless they are recorded in the Public Records at the Policy Date;
   c. that result in no loss to You; or
   d. that first occur after the Policy Date—this does not limit the coverage described in Covered Risk 7, 8.e., 25, 26, 27 or 28.
5. Failure to pay value for Your Title.
6. Lack of a right:
   a. to any land outside the area specifically described and referred to in paragraph 3 of Schedule A; and
   b. in streets, alleys, or waterways that touch the Land.

   This Exclusion does not limit the coverage described in Covered Risk 11 or 21.

HOMEOWNER'S POLICY OF TITLE INSURANCE

FOR A ONE-TO-FOUR FAMILY RESIDENCE

(2003)

Issued By

BLANK TITLE INSURANCE COMPANY

CONDITIONS

1. DEFINITIONS
   a. Easement—the right of someone else to use the Land for a special purpose.
   b. Known—things about which You have actual knowledge. The words "Know" and "Knowing" have the same meaning as Known.
   c. Land—the land or condominium unit described in paragraph 3 of Schedule A and any improvements on the Land which are real property.
   d. Mortgage—a mortgage, deed of trust, trust deed or other security instrument.
   e. Natural Person—a human being, not a commercial or legal organization or entity. Natural Person includes a trustee of a Trust even if the trustee is not a human being.
   f. Policy Date—the date and time shown in Schedule A. If the insured named in Schedule A first acquires the interest shown in Schedule A by an instrument recorded in the Public Records later than the date and time shown in Schedule A, the Policy Date is the date and time the instrument is recorded.
   g. Public Records—records that give constructive notice of matters affecting Your Title, according to the state statutes where the Land is located.
   h. Title—the ownership of Your interest in the Land, as shown in Schedule A.
   i. Trust—a living trust established by a human being for estate planning.
   j. We/Our/Us—Blank Title Insurance Company.
   k. You/Your—the insured named in Schedule A and also those identified in Section 2.b. of these Conditions.
2. CONTINUATION OF COVERAGE
   a. This Policy insures You forever, even after You no longer have Your Title. You cannot assign this Policy to anyone else.
   b. This Policy also insures:
      (1) anyone who inherits Your Title because of Your death;
      (2) Your spouse who receives Your Title because of dissolution of Your marriage;

(3) the trustee or successor trustee of a Trust to whom You transfer Your Title after the Policy Date; or

(4) the beneficiaries of Your Trust upon Your death.

c. We may assert against the insureds identified in Section 2.b. any rights and defenses that We have against any previous insured under this Policy.

3. HOW TO MAKE A CLAIM

a. Prompt Notice Of Your Claim

(1) As soon as You Know of anything that might be covered by this Policy, You must notify Us promptly in writing.

(2) Send Your notice to **Blank Title Insurance Company**, _____, Attention: Claims Department. Please include the Policy number shown in Schedule A, and the county and state where the Land is located. Please enclose a copy of Your policy, if available.

(3) If You do not give Us prompt notice, Your coverage will be reduced or ended, but only to the extent Your failure affects Our ability to resolve the claim or defend You.

b. Proof Of Your Loss

(1) We may require You to give Us a written statement signed by You describing Your loss which includes:

(a) the basis of Your claim;

(b) the Covered Risks which resulted in Your loss;

(c) the dollar amount of Your loss; and

(d) the method You used to compute the amount of Your loss.

(2) We may require You to make available to Us records, checks, letters, contracts, insurance policies and other papers which relate to Your claim. We may make copies of these papers.

(3) We may require You to answer questions about Your claim under oath.

(4) If you fail or refuse to give Us a statement of loss, answer Our questions under oath, or make available to Us the papers We request, Your coverage will be reduced or ended, but only to the extent Your failure or refusal affects Our ability to resolve the claim or defend You.

4. OUR CHOICES WHEN WE LEARN OF A CLAIM

a. After We receive Your notice, or otherwise learn, of a claim that is covered by this Policy, Our choices include one or more of the following:

(1) Pay the claim;

(2) Negotiate a settlement;

(3) Bring or defend a legal action related to the claim;

(4) Pay You the amount required by this Policy;

(5) End the coverage of this Policy for the claim by paying You Your actual loss resulting from the Covered Risk, and those costs, attorneys' fees and expenses incurred up to that time which We are obligated to pay;

(6) End the coverage described in Covered Risk 16, 18, 19 or 21 by paying You the amount of Your insurance then in force for the particular Covered Risk, and those costs, attorneys' fees and expenses incurred up to that time which We are obligated to pay;

(7) End all coverage of this Policy by paying You the Policy Amount then in force, and those costs, attorneys' fees and expenses incurred up to that time which We are obligated to pay;

(8) Take other appropriate action.

b. When We choose the options in Sections 4.a. (5), (6) or (7), all Our obligations for the claim end, including Our obligation to defend, or continue to defend, any legal action.

c. Even if We do not think that the Policy covers the claim, We may choose one or more of the options above. By doing so, We do not give up any rights.

5. HANDLING A CLAIM OR LEGAL ACTION

a. You must cooperate with Us in handling any claim or legal action and give Us all relevant information.

b. If You fail or refuse to cooperate with Us, Your coverage will be reduced or ended, but only to the extent Your failure or refusal affects Our ability to resolve the claim or defend You.

c. We are required to repay You only for those settlement costs, attorneys' fees and expenses that We approve in advance.

d. We have the right to choose the attorney when We bring or defend a legal action on Your behalf. We can appeal any decision to the highest level. We do not have to pay Your claim until the legal action is finally decided.

e. Whether or not We agree there is coverage, We can bring or defend a legal action, or take other appropriate action under this Policy. By doing so, We do not give up any rights.

6. LIMITATION OF OUR LIABILITY

a. After subtracting Your Deductible Amount if it applies, We will pay no more than the least of:

(1) Your actual loss;

(2) Our Maximum Dollar Limit of Liability then in force for the particular Covered Risk, for claims covered only under Covered Risk 16, 18, 19 or 21; or

(3) the Policy Amount then in force.

and any costs, attorneys' fees and expenses that We are obligated to pay under this Policy.

b. If We pursue Our rights under Sections 4.a.(3) and 5.e. of these Conditions and are unsuccessful in establishing the Title, as insured:

(1) the Policy Amount then in force will be increased by 10% of the Policy Amount shown in Schedule A, and

(2) You shall have the right to have the actual loss determined on either the date the claim was made by You or the date it is

settled and paid.

c. (1) If We remove the cause of the claim with reasonable diligence after receiving notice of it, all Our obligations for the claim end, including any obligation for loss You had while We were removing the cause of the claim.

(2) Regardless of 6.c.(1) above, if You cannot use the Land because of a claim covered by this Policy:

(a) You may rent a reasonably equivalent substitute residence and We will repay You for the actual rent You pay, until the earlier of:

(i) the cause of the claim is removed; or

(ii) We pay You the amount required by this Policy. If Your claim is covered only under Covered Risk 16, 18, 19 or 21, that payment is the amount of Your insurance then in force for the particular Covered Risk.

(b) We will pay reasonable costs You pay to relocate any personal property You have the right to remove from the Land, including transportation of that personal property for up to twenty-five (25) miles from the Land, and repair of any damage to that personal property because of the relocation. The amount We will pay You under this paragraph is limited to the value of the personal property before You relocate it.

d. All payments We make under this Policy reduce the Policy Amount then in force, except for costs, attorneys' fees and expenses. All payments We make for claims which are covered only under Covered Risk 16, 18, 19 or 21 also reduce Our Maximum Dollar Limit of Liability for the particular Covered Risk, except for costs, attorneys' fees and expenses.

e. If We issue, or have issued, a Policy to the owner of a Mortgage that is on Your Title and We have not given You any coverage against the Mortgage, then:

(1) We have the right to pay any amount due You under this Policy to the owner of the Mortgage, and any amount paid shall be treated as a payment to You under this Policy, including under Section 4.a. of these Conditions;

(2) Any amount paid to the owner of the Mortgage shall be subtracted from the Policy Amount then in force; and

(3) If Your claim is covered only under Covered Risk 16, 18, 19 or 21, any amount paid to the owner of the Mortgage shall also be subtracted from Our Maximum Dollar Limit of Liability for the particular Covered Risk.

f. If You do anything to affect any right of recovery You may have against someone else, We can subtract from Our liability the amount by which You reduced the value of that right.

7. TRANSFER OF YOUR RIGHTS TO US

a. When We settle Your claim, We have all the rights and remedies You have against any person or property related to the claim. You must not do anything to affect these rights and remedies. When We ask, You must execute documents to evidence the transfer to Us of these rights and remedies. You must let Us use Your name in enforcing these rights and remedies.

b. We will not be liable to You if We do not pursue these rights and remedies or if We do not recover any amount that might be recoverable.

c. We will pay any money We collect from enforcing these rights and remedies in the following order:

(1) to Us for the costs, attorneys' fees and expenses We paid to enforce these rights and remedies;

(2) to You for Your loss that You have not already collected;

(3) to Us for any money We paid out under this Policy on account of Your claim; and

(4) to You whatever is left.

d. If You have rights and remedies under contracts (such as indemnities, guaranties, bonds or other policies of insurance) to recover all or part of Your loss, then We have all of those rights and remedies, even if those contracts provide that those obligated have all of Your rights and remedies under this Policy.

8. THIS POLICY IS THE ENTIRE CONTRACT

This Policy, with any endorsements, is the entire contract between You and Us. To determine the meaning of any part of this Policy, You must read the entire Policy and any endorsements. Any changes to this Policy must be agreed to in writing by Us. Any claim You make against Us must be made under this Policy and is subject to its terms.

9. INCREASED POLICY AMOUNT

The Policy Amount then in force will increase by ten percent (10%) of the Policy Amount shown in Schedule A each year for the first five years following the Policy Date shown in Schedule A, up to one hundred fifty percent (150%) of the Policy Amount shown in Schedule A. The increase each year will happen on the anniversary of the Policy Date shown in Schedule A.

10. SEVERABILITY

If any part of this Policy is held to be legally unenforceable, both You and We can still enforce the rest of this Policy.

11. ARBITRATION

a. If permitted in the state where the Land is located, You or We may demand arbitration.

b. The law used in the arbitration is the law of the state where the Land is located.

c. The arbitration shall be under the Title Insurance Arbitration Rules of the American Land Title Association ("Rules"). You can get a copy of the Rules from Us.

d. Except as provided in the Rules, You cannot join or consolidate Your claim or controversy with claims or controversies of other persons.

e. The arbitration shall be binding on both You and Us. The arbitration shall decide any matter in dispute between You and Us.

f. The arbitration award may be entered as a judgment in the proper court.

12. CHOICE OF LAW

The law of the state where the Land is located shall apply to this policy.

CLTA Homeowner's Policy of Title Insurance (01/01/08)

ALTA Homeowner's Policy of Title Insurance (01/01/08)

Schedule A

HOMEOWNER'S POLICY OF TITLE INSURANCE
FOR A ONE-TO-FOUR FAMILY RESIDENCE

(2008)

Issued by

BLANK TITLE INSURANCE COMPANY

SCHEDULE A

Our name and address is: Blank Title Insurance Company
(Company Name)
(Company Address)

Policy No.: _____ Premium: $ _____

Policy Amount: $ _____ Policy Date [and Time]: _____

Deductible Amounts and Maximum Dollar Limits of Liability For Covered Risk 16, 18, 19 and 21:

	Your Deductible Amount	Our Maximum Dollar Limit of Liability
Covered Risk 16:	__% of Policy Amount or $_____ (whichever is less)	$_____
Covered Risk 18:	__% of Policy Amount or $_____ (whichever is less)	$_____
Covered Risk 19:	__% of Policy Amount or $_____ (whichever is less)	$_____
Covered Risk 21:	__% of Policy Amount or $_____ (whichever is less)	$_____

Street Address of the Land:

1. Name of insured:
2. Your interest in the Land covered by this Policy is:
3. The Land referred to in this Policy is described as:

CLTA Homeowner's Policy of Title Insurance (01/01/08)
ALTA Homeowner's Policy of Title Insurance (01/01/08)
Schedule B

HOMEOWNER'S POLICY OF TITLE INSURANCE
FOR A ONE-TO-FOUR FAMILY RESIDENCE

(2008)

Issued by

BLANK TITLE INSURANCE COMPANY

SCHEDULE B

EXCEPTIONS

In addition to the Exclusions, You are not insured against loss, costs, attorneys' fees, and expenses resulting from:
CLTA Homeowner's Policy of Title Insurance (01/01/08)
ALTA Homeowner's Policy of Title Insurance (01/01/08)
Owner's Information Sheet

HOMEOWNER'S POLICY OF TITLE INSURANCE
FOR A ONE-TO-FOUR FAMILY RESIDENCE

(2008)

Issued by

BLANK TITLE INSURANCE COMPANY

OWNER'S INFORMATION SHEET

Your Title Insurance Policy is a legal contract between You and Us.

It applies only to a one-to-four family residence and only if each insured named in Schedule A is a Natural Person. If the Land described in Schedule A of the Policy is not an improved residential lot on which there is located a one-to-four family residence, or if each insured named in Schedule A is not a Natural Person, contact Us immediately.

The Policy insures You against actual loss resulting from certain Covered Risks. These Covered Risks are listed beginning on page ____ of the Policy. The Policy is limited by:

Provisions of Schedule A

Exceptions in Schedule B

Our Duty To Defend Against Legal Actions On Page _____

Exclusions on page __

Conditions on pages __ and __.

You should keep the Policy even if You transfer Your Title to the Land. It may protect against claims made against You by someone else after You transfer Your Title.

IF YOU WANT TO MAKE A CLAIM, SEE SECTION 3 UNDER CONDITIONS ON PAGE __.

The premium for this Policy is paid once. No additional premium is owed for the Policy.

This sheet is not Your insurance Policy. It is only a brief outline of some of the important Policy features. The Policy explains in detail Your rights and obligations and Our rights and obligations. Since the Policy—and not this sheet—is the legal document,

YOU SHOULD READ THE POLICY VERY CAREFULLY.

If You have any questions about Your Policy, contact:

BLANK TITLE INSURANCE COMPANY

_____

_____

CLTA Homeowner's Policy of Title Insurance (01/01/08)

ALTA Homeowner's Policy of Title Insurance (01/01/08)

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FOR A ONE-TO-FOUR FAMILY RESIDENCE

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1. Name of Insured
2. Interest in Land Covered
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SCHEDULE B—EXCEPTIONS

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Source: Real Property/California Title Insurance Practice/Directory

Directory

§1.8

The California Department of Insurance Internet site is located at:

http://www.insurance.ca.gov

§4.32

The "Minimum Standard Detail Requirements and Accuracy Standards for ALTA/ACSM Land Title Surveys" may be obtained for $4.00 from the American Land Title Association:

American Land Title Association
1828 L Street NW, Suite 705
Washington, DC 20036
(202) 296-3671
(800) 787-2582
http://www.alta.org

§6.5

The looseleaf or CD-ROM version of a policy and endorsement forms book is available from the California Land Title Association:

California Land Title Association
1215 K Street, Suite 1816
Sacramento, CA 95814
(916) 444-2647
http://www.clta.org

§8.4

The Fannie Mae website is:

http://www.fanniemae.com

A free PDF version of the Fannie Mae Selling Guide (regularly updated) is available, and a printed version may be purchased, at the following URL:

https://www.efanniemae.com/sf/guides/ssg/#pv

The website for the Freddie Mac Single-Family Seller/Servicer Guide (1996) (regularly updated) is:

http://www.freddiemac.com/sell/guide

§8.10

The telephone number for Standard & Poor's Ratings Research Department is:

(212) 438-2400
http://www2.standardandpoors.com

§14.13

The most recent version of the title insurance arbitration rules of the American Arbitration Association are covered by the Commercial Arbitration Rules and Mediation Procedures (CARs) (including Procedures for Large, Complex Commercial Disputes). They are published on the following website:

http://www.adr.org

A copy of the latest Code of Procedure (COP Rules) of the National Arbitration Forum (NAF) may be found at the following website:

http://www.arb-forum.com

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