LOSS ISSUES

(or, when it can't be fixed, this is what comes next …)

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Once it has been determined that a claim is a covered matter, and once it becomes clear that the title issue cannot be cured (or can only be partially cured), then we arrive at the question of whether there has been a loss for which a title insurer is obligated to indemnify the insured. As always, the policy language is the starting point for determining whether there is a compensable loss. And, as always, we have a variety of court decisions, nationwide, which do not consistently interpret the relevant provisions of the standard owner's and lender's policies. That said, the following is a high level (as in, high in the sky and looking down!) overview of the relevant portions of the standard ALTA Owner and Loan policies as well as some of the court decisions which have shaped determinations of the timing of when a loss is deemed to have been incurred, how to measure a loss, and whether there is a compensable loss at all. For a low level (as in close up and in-depth) review of the issues related to loss under a title insurance policy, I recommend reading Bush Nielsen's *Title & Escrow Claims Guide*, or, for a sometimes contrasting view, Joyce D. Palomar's *Title Insurance Law* (as an added bonus, recognizing that not all of us are

equally excited about title insurance law, these books can also serve as a sleep aid. . .) So, without further ado – the policy language!

Relevant Policy Provisions

As a preliminary matter, a title insurance policy is an indemnity contract, not a guaranty of title. (See e.g. *Green v. Evesham Corp*., 430 A.2d 944, 946 (N.J. Super. Ct. 1981) ("It is settled that a title insurance policy is a contract of indemnity under which the insurer agrees to indemnify its insured in a specified amount against loss through defects of title to, or liens or encumbrances on, realty in which the insured has an interest.") A title insurance policy obligates the insurer to indemnify an insured for actual loss (not exceeding the policy limits) caused by certain title issues/defects – in other words, an insurer may be required to make a monetary payment to its insured, but is not required to give an insured perfect title. In order to determine when, if, and how much of a loss is to be paid, the following portions of the policy are particularly relevant:

> **SUBJECT TO THE EXCLUSIONS FROM COVERAGE, THE EXCEPTIONS FROM COVERAGE CONTAINED IN SCHEDULE B, AND THE CONDITIONS, _____TITLE INSURANCE COMPANY, a _____ corporation (the "Company") insures as of the Date of Policy and, to the extent stated in Covered Risks 9 and 10 [Owner's Policy] [Covered Risks 11, 13 and 14 – Loan Policy], after Date of Policy, against loss or damage, not exceeding the Amount of Insurance, sustained or incurred by the Insured by reason of: [enumerated title issues/defects, including: Title being vested as stated in**

Schedule A,; any defect in or lien or encumbrance of the Title; no right of access to or from the Land etc.][1]

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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: . . .

3. Defects, liens, encumbrances, adverse claims, or other matters

(c) resulting in no loss or damage to the Insured Claimant

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CONDITIONS

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

[1] Excerpts above and throughout these materials, unless otherwise noted, are from the 2006 American Land Title Association Owner's Policy and/or Loan Policy.

possible, the basis of calculating the amount of the loss or damage.

…

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 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 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**
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> **(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 LIABILTY

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 lesser of

(i) the Amount of Insurance; or[2]

(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.

[2] The Loan policy included the "indebtedness" as an additional limit.

(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.

…

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. [Owner's Policy]

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. [Loan Policy]

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. [Owner's 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.

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Read together, these policy provisions, in essence, provide that payment may be due an insured when there is **a covered title defect** and **that defect has caused** the insured **actual loss.** It should be noted that the title insurer has several alternatives, under the policy, other than simply paying the insured its actual loss. These options include: paying the insured policy limits; settling with the insured or a third party with an adverse interest; successfully litigating the matter; curing the title defect; or buying an insured lender's note. However, if these options are not viable, or from a practical perspective, more costly than compensating an insured for a loss, then we are back to making a determination of when/if a loss has been incurred and the amount of the loss.

Following is a look at some of the common questions which arise when assessing the existence of loss under a title policy.

Common Questions/Issues

A. Is there a compensable loss – or why do we have exclusion 3(c)?

As set forth above, the standard ALTA policies initially identify the risks that the policy insures against, and provide that the policy insures against "loss or damage" to the insured caused by one of the identified risks. In addition, exclusion 3(c) provides that "[d]effects , liens, encumbrances, adverse claims, or other matters…resulting in no loss or damage to the insured claimant" are not covered. In other words, it is possible to have a title defect which is a covered risk, but which is not causing damage or loss to the insured, and, if that situation occurs, there is not a compensable loss under the policy.

This exclusion has been examined by various courts in connection with a number of issues, two of the most common are discussed below.

(1) Does the mere existence of a title defect constitute a loss under the policy, or, must an insured have an out of pocket loss before it can have a valid claim?

The answer to this is, it depends, and specifically, it depends on whether we are dealing with an owner or a lender. With respect to an owner and an owner's policy, the majority of courts hold that an owner insured can have a loss as soon as a defect is identified, and without any out of pocket loss. The reasoning behind these holdings is that an insured owner suffers a loss from the mere existence of a lien or encumbrance because the fee interest is immediately diminished. (See *Bohr v First American Title Ins. Co*., 2008 WL 2977353 (M.D. Fla. 2008); *Summonte v First American Title Ins. Co.*, 180 N.J. Super. 605, 436 A.2d 110 (1981))

In contrast, the majority of courts have held that with respect to a loan policy, the insured lender generally does not have a loss (despite the existence of a title issue) unless the loan is not repaid and, as a result of the title defect, the lender is unable to collect the full amount it is owed. (See *Green v Evesham Corp*., 179 N.J. Super. 105, 430 A. 2d 944 (App.Div. 1981*); Blackhawk Production Credit Ass'n v Chicago Title Ins. Co*., 144 Wis. 2d 68, 423 N.W.2d 521 (1988).) For example, it may turn out that there is a judgment which has priority over an insured deed of trust – however, so long as the borrower is making payments to the lender, it is not suffering a loss; or should the borrower default and the lender forecloses, if the lender is ultimately repaid the amount it is owed out of the foreclosure, again, no loss.

(2) Is the title defect (which has been not excluded or excepted) the cause of loss incurred by an insured?

In order to have a compensable loss, not only must there be a covered defect and not only must there be a loss, but, the loss must have been proximately caused by the defect. For example, a number of cases have drawn a distinction between compensable losses caused by a title defect and noncompensable losses caused by a decrease in market value due to issues with the physical condition of property. See *Camp v Commonwealth Land Title Ins. Co*. 787 F2d 1258 (8th Cir. 1986) (insured loss resulted from flooding of house, not undisclosed restrictive covenant). Courts have also made it clear, that, regardless of the existence of a title defect, loss caused merely by the inadequate value of the collateral is not compensable. See *Focus Inv. Associates, Inc. v American Title Ins. Co*., 992 F.2d 1231 (1st Cir. 1993) (title insurer not liable for the lender's failure to be sufficiently

collateralized; if the insured lender's lien was valueless even without the existence of the title defect, an undisclosed lien, the insured lender did not have a compensable loss.)

B. So there is a compensable loss – but how do you measure it?

Prior to the 1987 revisions to the Owner's and Loan policies, the title insurer's liability was limited to the least of (1) the policy limits or (2) the insured's "actual loss". A fair amount of litigation ensued over the meaning of "actual loss" and the mechanics of measuring loss. The post-1987 versions of the standard policies made it clear that the measure of loss is the lesser of (1) policy limits or (2) the difference between the value of the Title as insured and the value of the Title subject to the risk insured against by the policy – in other words, the difference between what the property is worth without the title defect and what it is worth with the defect, often referred to as "diminution in value". (Conditions, 8 – 2006 ALTA Policies)

A title defect can cause a complete failure of title or it may only cause a partial failure. For example, with respect to an owner, a partial loss may be caused by the existence of a lien in an amount less than the full value of the property, an easement, or lack of ownership of all of the land described in the policy. With respect to a lien or encumbrance, the measure of damages will be the difference between the value of the property with and without the lien or encumbrance – often the amount necessary to remove/pay the lien. Diminution in value caused by an easement or encroachment can be more difficult to determine and factors such as location and size of the easement or encroachment will need to be considered and typically professional appraisers are involved in this determination.

For examples of case law pondering/applying this standard of measurement see *Miller v Title, U.S.A., Inc. Ins. Corp. of N.Y.*, 1991 WL 24537 (Tenn. Ct. App. 1991; *Security Union Title Ins. Co. v RC Acres, Inc.*, 269 Ga. App. 359, 604 S.E.2d 547 (2004). In the event of a complete failure of title for an owner, the loss will either be the value of the property or policy limits, whichever is less.

The calculations for a lender's loss are very similar, with one additional limitation: the amount of the outstanding indebtedness secured by the lender's insured deed of trust. Thus, if an insured deed of trust or mortgage is unenforceable, in part or in its entirety, the loss will be the lesser of the policy limits, the market value of the property securing the deed of trust, or the amount still due on the note secured by the insured deed of trust. See *Interbay Funding, LLC v Lawyers Title Ins. Corp*., 2003 WL 22939275 (E.D. Pa. 203)

C. Now you know (generally) how to measure loss – but when do you measure it?

As discussed above, the measure of loss is the difference between the value of the property as insured and its value subject to the title defect. Thus the question arises, on what date should these values be compared? Early ALTA policies did not address this issue at all. The 2006 policies only address it in the situation where the insurer chooses to litigate to defend a claim and/or cure a title issue. Under these circumstances Condition 8(b)(ii) provides that the insured has the right to "have the loss or damage determined either as of the date the claim was made…or as of the date it is settled and paid." Thus, the insured can chose the date the comparative valuation is made.

When a date is not specified in a policy, not surprisingly, courts across the country have reached varying conclusions on the appropriate time frame. A number of courts have concluded that the policy date (generally the date the insured acquired an interest in the property) is the property date. See *Citicorp Sav. Of Illinois v Stewart Title Guar. Co.*, 840 F.2d 526 (7th Cir. 1988). The problem with using the policy date to measure the value of the land is the risk that, since the policy was issued, the land's value has declined due to market conditions – a risk that should belong to the insured.

The date the title defect was created is another date courts have used to assess diminution in value. See *Overton v Ticor Title Ins. Co*., 1991 WL 28938 (Tenn. Ct. App. 1991) Some courts have also looked to the date of the trial in which the title defect was established (although the current 2006 condition 8(b)(ii) would seem to address this situation). Most courts which have addressed this issue, however, have used the date the defect was discovered. See *Allison v Ticor Title Ins. Co.,* 907 F.2d 645 (7th Cir. 1990); *Swanson v Safeco Title Ins. Co*. 186 Ariz. 637, 925 P.2d 1354 (1995); *Jalowitz v Ticor Title Ins. Co.*, 165 Wis. 2d 392, 478 N.W.2d 67 (1991).

Conclusion

As mentioned in the introduction, this document is not meant to be an exhaustive treatment of this topic – that would require many more pages than most of us want to read in connection with a CLE. Instead, this document is meant to guide you to the policy provisions most relevant to loss issues and to serve as an overview of common questions which arise in the context of loss determinations. In short, there is very little North Carolina

law on point with respect to loss issues, which leaves us to look to the rationale of other courts – which is not always consistent on the various issues. Ultimately, when it comes to making determinations about loss in North Carolina, both the insured and insurer need to rely on a combination of the policy provisions, court opinions which provide guidance (but are likely not controlling), and a bit of common sense to reach the proper conclusions.