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Title Insurance and Escrow Report
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THE LIMITS TO TITLE INSURANCE PROTECTION AND THE ADVANTAGES OF ESCROW INSTRUCTIONS

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I. Introduction

It is difficult to imagine a substantial real estate transaction which does not have title insurance coverage and an escrow agent, although one can occur at times. Unfortunately, many of the beliefs about the presumed benefits of title insurance and escrow are incorrect. The purpose of this report, and those which follow, is to provide the reader with a general understanding of the true benefits of title insurance and escrow instructions.

II. Introduction to Title Insurance

The first policy of title insurance was issued in 1876 in Philadelphia, Pennsylvania. The need for title insurance was created by the case of Watson v. Muirhead (1868) 57 Pa. 161. In that case, the buyer employed a conveyancer to examine the seller's title and the Court held that the conveyancer was not negligent when he ignored, on the advice of counsel, the existence of a recorded judgment against the property. Accordingly, the innocent purchaser of the property suffered a failure of title, but had no recourse against the conveyancer because, although he had been wrong, he was not negligent. Accordingly, title insurance developed to provide some financial security relative to real property interests which was not based upon negligence.

Today, title insurance is available in all 50 states of the nation and is frequently available in foreign countries.

III. An Overview of the Title Insurance Industry

There are approximately 100 title insurers in the United States. However, the majority of the title insurance market is controlled by four major title insurers. Fidelity National Financial Inc. and its "family" of title insurance companies (i.e. Fidelity National Title Insurance Company, Chicago Title Insurance Company, Commonwealth Land Title Insurance Company, Alamo Title Insurance Company, Lawyers Title Company and Ticor Title Insurance Company) is the largest title insurer in the nation. First American Title Insurance Company is a close second. Stewart Title Guaranty Company and Old Republic National Title Insurance Company have substantially smaller shares of the market.

Title insurance is distributed in the United States in three principal ways. First, is the "direct" operation where the title insurer deals directly with the potential insured. Next is the underwritten title company or title agent whereby the insurer distributes its products through a network of designated agents. Frequently, in California the underwritten title company is an affiliate of the title insurance company and shares a common ownership and management. However, there still are a number of "independent" underwritten title companies in California which issue title insurance products for one or more title insurers. Title insurance, outside of California, is also issued through "approved attorneys." In many states, it is not uncommon for a law firm to have an affiliate which is a title agent.

A principal purpose of title insurance is to eliminate the title risk associated with a contemplated real estate transaction. This means that a title officer, underwriter, underwriting counsel or other responsible person at a title company, will purportedly review the proposed transaction to seek to identify and eliminate any potential title risk, the objective is to identify and eliminate title risks which may be present and to provide the insured with a policy of title insurance which provides protection in the future there are no problems which exist on or before the effective date of the policy of title insurance other than those identified in the policy. Unlike most insurance, title insurance only charges a single premium at the date the policy is issued. This practice of a single premium has a material effect on the business of title insurance.

IV. Regulation of the Title Insurance Industry

The title insurance industry is regulated on a state-by-state basis. The principal focus of regulation in most states is on the rates which are charged by the title insurer and the prohibition of any kickbacks and rebates. In 1990 the National Association of Insurance Commissioners ("NAIC") adopted the Unfair Claims Settlement Practices Act. California has adopted an Unfair Claim Settlement Practices Regulations, based on the NAIC model, which regulates all insurance companies with respect to the handling of claims on their policies of insurance.

V. Common Misconceptions About Title Insurance

The most common misconception about a preliminary report, commitment, binder or policy of title insurance is that they reflect the ". . . condition of title to real property . . ." Up until 1981, case law in California held that a preliminary title report could be relied upon to constitute a representation as to the condition of title to real property. See, Hardy v. Admiral Oil Co. (1961) 56 Cal. 2d. 836, 841. However, on January 26, 1981, at the request of the California Land Title Association, Assembly Bill 334 was introduced and Insurance Code § 12340.10, which defines an "abstract of title," and Insurance Code § 12340.11, which defines a "preliminary report," "commitment" and "binder," were the final result of that bill.

Insurance Code § 12340.10 reads as follows:

"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 Section 12340.2."

Insurance Code § 12340.11 reads as follows:

"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 issuer is willing to issue its title policy, if such offer is accepted.

Despite the fact that Insurance Code §§ 12340.10 and 12340.11 have been in existence for more 30 years in California, it is commonplace for persons in real estate transactions to proceed on the assumption that the "preliminary report," "commitment" or "binder" does in fact constitute a representation of the condition of title to real property. While **the preliminary report, commitment and binder, by statute, do not reflect the condition of title to real property**, title insurers issue other products, including property profiles, reports and various guaranties, including but not limited to a Recorded Document Guaranty and a Trustee's Sale Guaranty which do not have the express statutory protection which is provided by Insurance Code § 12340.11. At present, the authors are not aware of any California authority which deals with the issue of whether a person is entitled to rely upon the statements in a property profile, report or a guaranty as a representation as to the condition of title to real property. It is arguable that title companies, as professional suppliers of information within the meaning of the Restatement of the Law (Second) Torts 2d. Section 552, have liability for "information negligently provided for the guidance of others." See, Beard v. Worldwide Mortgage Corp. (W.D. Tenn. 2005) 354 F. Supp. 2d. 789, 813.

The second most common misconception about title insurance is that the preliminary report, commitment and binder disclose all matters which are in the "public records." **The reality is that it is not uncommon for a preliminary report, commitment or binder to not reflect all of the recorded documents**. There are a variety of reasons that all recorded documents may not be

reflected in the preliminary report, commitment or binder, including but not limited to, the type of product requested, errors in the plant search, posting errors, underwriting decisions, et cetera. For example, on occasion a title insurer will accept an indemnity and not reflect recorded mechanics' liens.

The third most common misconception about preliminary reports, commitments and binders is that they accurately describe the property with which you are dealing. The reality is that errors in property descriptions are commonplace for a variety of reasons, including that it is common practice to prepare a preliminary report based solely upon a street address. However, street addresses do not always accurately reflect the correct legal descriptions of the property which is the subject of the transaction. If a person wants to know the correct description of a parcel of real property, a survey should be obtained and then that survey should be endorsed into the policy of title insurance by obtaining the appropriate endorsement. (See, CLTA Endorsement No. 116.1-06).

Fourth, not all recorded documents provide constructive notice. Therefore, a document may be duly recorded and indexed in the Recorder's Office, but if it does not constitute constructive notice, the title insurer may elect to not reflect it in the preliminary report, commitment or binder. A memorandum of lease not signed by the owner of the property or on a vendor's lien not signed by the owner are two examples of recorded and indexed documents which might not be reflected in a preliminary report because they do not affect title to real property.

VI. The Principal Benefits of Title Insurance

The first advantage of title insurance is that the potential insured should receive the benefit of a "second pair of eyes" which had looked at the proposed transaction and identified any potential defects in the proposed transaction. Unfortunately, many title companies only do a limited amount of underwriting before the policy of title insurance is issued. Thereafter, if a claim is made on the policy, it is not uncommon for the title insurer to send the insured a request for a number of documents which it wants to review (for the first time) before it makes a determination as to whether it can approve or deny insurance coverage.

In contrast to an application for a policy of life insurance, where the potential insurer may ask about the applicant's health or have a medical examination performed on the applicant prior to issuing the policy of life insurance, it is not uncommon for title insurance companies to only perform extensive underwriting of the transaction after a claim is made. This is principally because of the cost of underwriting each and every transaction insured. The lower the monetary amount which is involved with the real property transaction, the lower the monetary premium which is charged for the policy of title insurance. While this "post-policy underwriting" is unfair and improper, it is a common practice in the title insurance industry. See, Exclusions 3(a) and 3(b). In extreme situations, the conduct of the title insurer has been found to constitute "post-policy underwriting" and the title insurer has been held liable to the insured for compensatory damages and bad faith damages. See, Fifth Third Mortgage Company v. Chicago Title Insurance Company (S.D. Ohio 2010) 758 F.Supp.2d 476, 480.

Two key grounds for denying claims under policies of title insurance are contained in Exclusions 3(a) and (b). Exclusion 3(a) ("Defects, liens, encumbrances, adverse claims or other matters . . ." which were " . . . created, suffered, assumed or agreed to by the Insured Claimant") is frequently raised as a defense to a claim by the insured on the ground that the claim arose because of the conduct of the insured. Similarly, Exclusion 3(b) ("Defects, liens, encumbrances, adverse claims or other matters . . ." which were ". . . 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") is raised on the grounds that the insured knew something which the insurer did not know and did not disclose it in writing to the insurer prior to the date that the policy was issued to the insured. As a result of the stringent and overreaching application of Exclusions 3(a) and 3(b) by title insurers, a number of insureds are making affirmative inquiries of their title company as to whether there is any information which is wanted or, in an abundance

of caution, are providing entire copies of their files to the title company before the transaction closes. Exclusions 3(a) and (b) will be the focus of a future issue of the Title Insurance and Escrow Report.

VII. The Benefits of Escrow Instructions

Escrow instructions and a policy of title insurance go together "hand in hand." A well-written set of escrow instructions will go a long way towards providing meaningful protection which may not be provided by the policy of title insurance alone. A subsequent report will discuss in greater detail the myriad of benefits which can be obtained by a well-written set of escrow instructions. However, for purposes of this report, suffice it to say that a well-written set of escrow instructions can strongly augment the protections provided by the policy of title insurance.

VIII. Conclusion

A policy of title insurance and a set of escrow instructions are customary with any substantial real property transaction. While there are other services, such as a survey, environmental assessment, et cetera, which may be involved in a real property closing, escrow instructions and title insurance policies are two of the most beneficial services available to eliminate the risks in the transaction. However, it must be remembered that the title insurer and the escrow agent may take different views as to the benefits provided, especially after a claim is made.

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