

First American[®] Law Report

Issue 15
Summer 1996

A publication of the First American Title Insurance Company Legal Department

USING ENDORSEMENTS TO TAILOR POLICY COVERAGES



by Kenneth R. Jannen

(Revised and reprinted from *Title News*, published by the American Land Title Association.)

It does not take much reflection to recognize that the standardization of insurance policy forms is a good thing. It lets the insured know, when he is ordering a policy, exactly what his coverage will be. The insurer knows what its obligations will be because the provisions of insurance policies have, through use in the marketplace and the occasional court case, reached a level of common understanding.

In a sense, title insurance forms are quasi-standardized. While the insuring provisions, "Exclusions from Coverage" and "Conditions and Stipulations," have been standardized through the American Land Title Association (ALTA) and similar state-level organizations, the information that is typed on Schedules "A" and "B" is determined on a local basis.

Efforts to standardize the wording of exceptions for Schedule "B" have been made through the issuance of manuals and guidelines by various title companies, but their use is limited by the willingness of those preparing the policies to consult and follow the guidelines, the "give and take" negotiation as to the language in exceptions between company personnel and representatives of the insured, and the fact that the particular title problem encountered may not exactly fit

with the recommended wording in the manual.

Title policy forms, however, frequently can be modified through the use of endorsements. Endorsement forms have been adopted by the ALTA and state land title organizations, promulgated by insurance commissioners, crafted by innovative underwriters, or forged through negotiation between company personnel and insureds' attorneys. These endorsements address many of the problems that are peculiar to particular title risks or transactions. Let's take a look at a few standard policy provisions and see how endorsements are used to treat them:

Insuring Provision No. 3 — Loss by Reason of Unmarketability of Title. Any title to land that is subject to doubt may be considered unmarketable. The concept of unmarketability derives from the principle that a court of equity will not force a person to proceed with an agreed-upon purchase, lease or loan to be secured by a mortgage, where title to the subject land may be in doubt, or there may be some title defect that could impair one's ability to use the land as intended.

In real life, these cases typically involve a missing signature, an erroneous legal description or a "broken" chain of title in the past.

Occasionally, an insurer may encounter a situation where the title is subject to doubt, but the insurer is confident the doubt is unfounded. Although willing to insure against the risk, the insurer may be reluctant to give standard marketability coverage.

A compromise may be reached by adding an endorsement to the policy describing the perceived "risk" and providing that it will not be considered to create an unmarketable condition so long as the insurer remains willing to issue new title insurance in the future providing coverage against the risk, or so long as another title insurer is willing to provide such coverage.

Insuring Provision No. 4 — Loss by Reason of Lack of a Right of Access to and from the Land. This insuring provision pertains to a legal right of access between the land and a public road, rather than a practical ability to get from the public road to the land.

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On occasion, the insured may have a need for coverage to the effect that his legal right of access is to a specific public road, such as where a parcel of commercial property is being insured and a right of access to and from particular roads is of importance to the insured's business. In that case, an "Access Endorsement" might be included in the policy.

Item 1(a) of the Exclusions From Coverage — Laws, Ordinances, or Governmental Regulations Relating to Zoning, Subdivision, Land Use, and Environmental Protection Laws. While the laws of some states prohibit zoning coverage by title insurance companies, in states where it is permitted, the insured may be able to obtain an endorsement such as the ALTA Form 3, which assures that the land falls under a particular zoning classification, which includes certain described uses. This endorsement is generally used for vacant land.

For improved land, the insured may request an ALTA Form 3.1 endorsement. In addition to the coverage given by the Form 3, the ALTA 3.1 also insures against loss or damage arising from a final court decree prohibiting the use of the land, with any structures located on it at the date of policy, as those uses are specified in the endorsement. This includes coverage against loss arising from court-ordered alteration or removal of a structure, due to zoning violations.

Exclusion 3(b) of the Exclusions From Coverage — Unrecorded Matters Known to the Insured. This exclusion relieves the insurer from liability for:

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

One of the problems an insured may face is that, while he may not have knowledge of a matter in fact, he may be deemed to have knowledge of the same matter by law. For instance, due to the relationship of partners, knowledge of one partner is imputed under the law to each other partner and to the partnership itself. The reason for this is that each partner is the agent of the other and of the partnership with regard to partnership matters. The law assumes that what one partner knows about a partnership-related

matter he will tell, or should reasonably be expected to tell, his fellow partners. This is sometimes referred to as "implied actual knowledge."

Suppose an individual wants to invest money in a partnership that will hold title to a piece of land that has been owned by his future partners. If those partners know of an unrecorded matter (perhaps one that they created themselves), the partnership may be bound by the unrecorded matter—and deemed not to be a bona fide purchaser under the recording act—because the partnership is deemed to know of the matter's existence.

The individual investing in the partnership, and who has had no prior relationship with the land, may request an assurance from the insurer that it will not deny liability as to otherwise covered matters, based solely upon the knowledge of his fellow partners. This is what is known as a "non-imputation endorsement."

While the non-imputation endorsement is not available in all states, for those jurisdictions where it is available, the title insurer may have certain conditions that must be met before it is issued, such as indemnities or affidavits from those partners who have had a relationship with the land, stating that they have neither created nor know of any matters that could create a lien on, or interest in, the land. These indemnities or affidavits may be accepted after a review of the financial statements of the indemnitors/affiants to make sure that, should their representations be erroneous, they will be in a position to respond in damages.

Item 5 of the Exclusions From Coverage — Usury and Similar Laws. This exclusion is for loss arising from invalidity or unenforceability of the insured mortgage due to a claim based upon a usury, consumer protection or truth-in-lending law.

Most states prohibit the collection of interest rates that their courts or legislatures deem to be excessive. Depending upon the laws of a given state, the charging of excessive interest may even invalidate the debt and the lien of the mortgage. Because of this, an insured may request usury coverage.

Due to the interstate nature of lending transactions, title insurers are reluctant to give this coverage in a blanket manner, but may be willing to give usury coverage with reference to the laws of a particular state. In many cases, a legal opinion from the borrower's attorney will be required, unless the law of the state is very clear in exempting the transaction from its usury laws. Some

states prohibit usury coverage.

Definition of "Insured" Under Item 1 — "Definition of Terms" in the Conditions and Stipulations. The definition of "insured" in an owner's policy reads as follows:

"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 representative, next of kin, or corporate or fiduciary successors."

The definition may become critical in a situation where the customer wants to modify or change the entity through which he is holding title to property. For instance, in a situation where title is held in the name of a general partnership, a change in the composition of the partnership by withdrawal or admission of members may effect a "dissolution" of the partnership under the Uniform Partnership Law. This situation was presented in the case of *Fairway Development Company v. Title Insurance Company of Minnesota*, 621 F. Supp. 120 (D.C. Ohio 1985), where an insured general partnership had taken title to a piece of property, purchased an owner's policy, and the partnership's composition had been modified by the substitution of partners. After the change in partners, a gas line easement, constituting an encumbrance on the title, was discovered. The title insurer denied liability, contending that its policy had lapsed due to the discontinuance of the existence of the insured partnership. Litigation ensued and the court held that the policy had indeed lapsed, due to the dissolution of the partnership, under the Uniform Partnership Law. Because of this issue, many real property practitioners representing general partnerships will request that the policy be issued with a "Change of Partners" or "Fairway" endorsement.

This issue may also apply in a situation where the customer contemplates that title will be conveyed at some point in the future to a related corporation or entity. While the insurer does not want to insure against the possibility of future changes in the title or future liens and encumbrances, it may be willing to extend its coverage to the contemplated future titleholder as of the original Date of Policy. The endorsement, known as an "Expanded Insured" or

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“Successor Insured” endorsement, describes a class of potential future owners who would be considered to be insureds under the policy, as of its original date.

Definition of “Land.” The policy insures, under its insuring provisions, various matters in connection with title to the land. The land is described on Schedule “A” by its physical boundaries, but its legal and physical extent is defined under item 1 of the Definition of Terms in the Conditions and Stipulations as follows:

“The land described or referred to in Schedule A, 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, 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.”

As you can see, covered improvements are limited to those improvements which by law constitute real property. The issue as to when an improvement constitutes real property comes into focus when we consider whether a manufactured housing unit or mobile home would fall within the definition. Mobile homes, as the name implies, are extremely portable, thus having the prime characteristic of personal property, as contrasted with real property. Bricks and mortar have the same characteristic of mobility, but once they are affixed to the land, they become real property. The difference, really, lies in the ease of removal, or extent of ability to physically sever the mobile home from the land.

A lender making a loan on property including a mobile home or “manufactured housing unit” will ask that the definition of land be endorsed to include the manufactured housing unit located on the land at date of policy. This has become a fairly common endorsement, but there are requirements, which vary by insurer and by state, with regard to what is necessary to provide this endorsement. Some examples of these requirements are: proof of removal of some of the characteristics that made the unit mobile, such as hitches and axles; assessment of the unit as real property or inclusion of the value of the unit in the tax assessment for the land; the termination of registration of the unit as a vehicle; and an

affidavit from the owner stating that the unit is and will continue to be considered and intended to be real property. Also, just to be on the safe side, title insurers sometimes require, if a mobile home with a certificate of title is involved, that the certificate show the borrower to be the owner and that the lender be listed as a lienor.

The Reduction of Insurance, under Subparagraph 9(b) of the Conditions and Stipulations. This paragraph provides that payments of principal of the indebtedness secured by a mortgage insured under a loan policy reduces the amount of insurance pro tanto.

Generally, title insurers issue a loan policy for the principal amount of the indebtedness secured by the insured mortgage. In some situations, we insure for less than the full amount of the indebtedness because the value of the mortgage as security is itself less. For instance, a borrower may borrow \$100 million, but the loan may be secured by other kinds of property (such as liens on vehicles and other equipment), a letter of credit, or loan guarantees. The value of the land, as security, may only be \$10 million. In that instance, we may insure the mortgage for the \$10 million land value.

Now consider what would happen in our example of the \$100 million loan, where we have insured the mortgage for \$10 million, and the loan is paid down to \$90 million. Under the reduction of insurance provision, as each dollar is paid on the principal balance, the amount of insurance is reduced by one dollar. The amount of the coverage under the policy has been reduced by the \$10 million that has been paid on the loan, but that was the full amount of coverage under the policy! According to subparagraph 9(b), the reductions in the indebtedness have extinguished the coverage.

To avoid this situation, the lender may ask for what is known as a “Last Dollar Endorsement,” which indicates that the amount of insurance will not begin to be reduced until the indebtedness has been reduced to the amount of insurance stated in the policy.

Limitation of Liability under Subparagraph 8(d) of the Conditions and Stipulations. This provision states that, except for certain advances made under construction loans secured by the insured mortgage, indebtedness created after the date of policy (except for certain advances made to protect the lien of the insured mortgage or

value of the security) will not be covered under the policy.

What about a situation where the insured mortgage secures a revolving credit loan? The indebtedness under the revolving credit loan is advanced, paid down, and readvanced through the life of the loan. Without an endorsement to overcome subparagraph 8(b), the re-advances, being after the date of policy, would not be covered.

Because of this, lenders request “Future Advance” or “Revolving Credit” endorsements. These endorsements also address the effect of Exclusion 3(d) of the loan policy, which states that (with certain exceptions) the policy does not insure against matters attaching or created subsequent to date of policy.

Revolving credit or future advance endorsements may vary from state to state, depending upon whether or not the lender may advance to the borrower if it knows that the land has been conveyed to another, or whether it may gain a priority for these advances over intervening liens or encumbrances of which it may have actual or constructive notice. Advances made subsequent to the filing of a bankruptcy by the borrower are generally excluded from coverage, as are environmental protection liens, federal tax liens, ad valorem taxes and assessments imposed by governmental authority.

Conclusion

While the scope of this article is limited, the ability to innovate on the part of the title industry and its customers is not. There are literally hundreds of recognized formats for endorsements, either modifying title policy provisions, adding covered risks, or qualifying exceptions shown on Schedule B in order to maximize coverage. Many more endorsements continue to be created for specific transactions and may evolve into widespread use.

While it sometimes induces anxiety, innovation is fun and helps the title industry to provide a product that is useful to its insureds as their needs change. As long as we, in the industry, maintain an open mind and a circumspect willingness to serve, we will continue adding to the recognized value of title insurance in facilitating real property transactions.

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Courts Illustrated

Government Forfeiture Prevails Over “Innocent” Lender



Crime Scene: Where an unwitting lender got mugged.

In April 1992 Colonial National Bank loaned \$44,000 to Jerry C. Kibler, secured by a deed of trust against Kibler’s residence at 6915 Hillmeade Road, Bowie, Maryland.

Unbeknownst to Colonial, Kibler’s residence had been forfeited to the federal government three months earlier by a federal court judgment entered January 16, 1992, as the property had been used in illegal drug activity.

When the government learned of Colonial’s deed of trust, it filed a motion to re-open the forfeiture action to include Colonial as a party to be bound by the judgment of forfeiture.

Colonial opposed the government’s motion, arguing that its deed of trust should not be subject to the forfeiture action because the government failed to record a notice of lis pendens, and Colonial claimed to have no other notice of the action when it made its loan to Kibler. In effect, Colonial claimed to be a bona fide purchaser without prior knowledge of the government’s off-record claim to the property.

The trial court granted the government’s motion, and the federal Court of Appeals for the Fourth Circuit affirmed the trial court decision.

Relying on previous U.S. Supreme Court decisions, the Court of Appeal reasoned that the judgment of forfeiture was as valid and

effectual as a recorded deed, even though it was not recorded, and that once the judgment was issued, vesting of the government’s title related back to the “moment when the property became forfeitable,” i.e., when the crime giving rise to forfeiture was committed. Although not specified in the Court of Appeal’s decision, this would be a date even before January 16, 1992.

Since Kibler had no interest to convey in April 1992, the deed of trust Colonial took from him was a nullity.

The official citation is *United States vs. Colonial National Bank*, 74 F.3d 486 (4th Cir. 1996).

In Bankruptcy, Creditor with Unrecorded Mortgage Denied Equitable Relief



Home Improvement: As redone, Bridge’s Victorian became a nifty office/commercial property.

Frank Bridge borrowed \$260,000 for renovation of his property at 94 South Main Street, Ocean Grove, New Jersey.

The \$260,000 loan was secured by a mortgage in favor of Midlantic National

Bank, which was recorded on April 3, 1987, in the Monmouth County Clerk’s Office.

Bridge and Midlantic later agreed to refinance the loan and, on October 18, 1988, Bridge gave Midlantic a new mortgage, also for \$260,000, against the property. The new loan proceeds were used to discharge the loan secured by the original mortgage.

In both of these loan transactions Bridge was represented by an attorney who also acted as a settlement agent. This attorney certified to Midlantic that the new mortgage had been sent for filing and was now the first mortgage against the property.

Unbeknownst to Midlantic, however, and for reasons unknown, the new mortgage was not recorded in 1988, nor even in 1989. In fact, the next notable event was on July 13, 1990, when the original mortgage was satisfied of record.

On August 15, 1990, Bridge filed a Chapter 7 bankruptcy. It was not until September 12, 1990, that Midlantic finally recorded the mortgage executed by Bridge on October 18, 1988.

A trustee was appointed in the Bridge bankruptcy, and the trustee took the position that the Midlantic mortgages could be avoided as an interest in Bridge’s real

property because the original mortgage was satisfied of record, and the new mortgage was not yet recorded at the time the bankruptcy was commenced.

The trustee relied on a literal reading of Bankruptcy Code Section 544(a)(3), which gives the trustee the status of a hypothetical bona fide purchaser as of the date of commencement of bankruptcy. By definition, a bona fide purchaser is

one who, acting in good faith, pays valuable consideration for property without knowl-

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forgery reward

no. 956

Since 1984 First American has offered a reward of \$500 to any employee in four western states who detects and prevents First American from relying upon a false signature in a real estate transaction.

In early February 1996, First American was asked to handle the sale of a single-family residence at Stateline, Nevada. The sellers were Monte and Julie Meier, husband and wife. The sale price was \$59,000, to be paid in cash at close of escrow. An owner's title policy was ordered for the buyer.

As the preliminary report was being prepared, escrow officer Marilyn Bigham noticed that the wife's signature was illegible on the Offer and Acceptance Form submitted to escrow and, curiously, the handwriting differed from signatures of Julie Meier on prior deeds of trust given against the property in 1973 and 1985.

The escrow officer called the listing realtor and mentioned her concern about Julie's signature. The realtor said he was sure there was a Julie, and he understood she was now working in Las Vegas but would return to sign the deed needed to close escrow.

On February 22, Monte Meier called to report that Julie was in town and the couple would be in to sign documents.

Soon the couple appeared and documents

were signed. The escrow officer asked to see current driver's licenses held by Monte and Julie so she could notarize the deed.

Monte's license was produced and his signature notarized, but Julie had a problem. Julie explained that her purse was stolen at the airport and she had no identification to provide. She offered to sign then and there, and fax over some type of i.d. after returning home.

The escrow officer explained that the deed could not be recorded, and the deal couldn't close, until Julie provided i.d. and her signature was notarized.

The couple got upset and asked to be given another copy of the deed to be signed elsewhere.

Later, Monte returned with the deed fully signed and notarized. The escrow officer called the outside notary to confirm Julie's identification.

The other notary readily admitted he hadn't pressed Julie for current i.d., but instead accepted her tale of the stolen purse.

The frustrated escrow officer once again called the realtor to explain her problem. He couldn't help. Then she called Monte to explain further that she couldn't close without a reliably notarized deed.

When nothing further was heard from the couple or their realtor, the incident was

submitted under First American's forgery reward program. In late April, forgery reward No. 956 was paid to Marilyn Bigham.

On May 16, 1996, Douglas County sheriff's deputies found the body of Julie Meier buried in a shallow grave under a wood pile in the yard of the Stateline residence. Her grown children had reported Mrs. Meier missing in May 1994, but Monte Meier told investigators she had deserted him and gone to work in Laughlin, Nevada. Finally, on May 13, 1996, a Meier daughter told police she had spoken with her father and he now admitted Julie Meier was dead and her body was buried in the yard.

Monte Meier showed deputies where to look for his wife's remains, but he denies knowledge of the circumstances of her death. He says he awoke one evening in January 1994 and found her lying in a pool of blood, with injuries to the back of her head.

Mr. Meier, 56, is an unemployed slot machine mechanic. Neighbors and family members say he had a history of abusing and battering his wife, usually after drinking heavily. He is being held for trial after pleading innocent to charges of murder, destruction of evidence and forgery.

Autopsies have failed to establish a cause of death for Julie Meier.



Claims CHRONICLES

Pick-Off Play



Out at First? *The original motel, foreground. Alterations to this property, along with new financing and loan modifications to facilitate construction next door, jeopardized priority of the insured lender's deed of trust.*



Build to Suit: *Lawsuit, that is. The former vacant parcel, center, now a full service hotel operating in competition with the motel.*

Arlington, Virginia — Like a base runner taking a lead, the lender in a mortgage assignment or loan modification needs to keep an eye on the ball.

Take, for example, this case: In 1984 a partnership owned two adjacent parcels in the Rosslyn section of Arlington, Virginia, just across the Key Bridge from Georgetown. One of these parcels was improved with a high-rise motel, and the other was vacant.

In November 1984 a purchase agreement was signed whereby both parcels were to be acquired by a limited partnership known as JLM Group. Under terms of this agreement, several partners of the seller partnership agreed to carry back notes and deeds of trust for a portion of the purchase price. At the same time, these sellers agreed to subordinate their carry-back deeds of trust to new financing obtained by the buyer, JLM Group.

The transaction closed in March 1985. By that time JLM Group obtained an acquisition and development loan from Dominion Federal Savings and Loan Association in the amount of \$14,500,000. Dominion agreed to make an initial disbursement of \$9,416,000, with the

remaining loan funds to be used for renovation of the existing motel and improvements to the vacant parcel.

At closing JLM Group gave deeds of trust against the parcel improved with the motel as follows: a first deed of trust to Dominion securing repayment of \$8,000,000; a second deed of trust to a seller/pension fund securing \$500,000; a third deed of trust to individual seller/partners securing \$750,000; and a fourth deed of trust to Dominion securing \$6,500,000. JLM Group also gave Dominion a first deed of trust against the vacant parcel, providing additional security in the amount of \$8,000,000.

Each of the Dominion deeds of trust was insured by First American.

In early 1986 JLM Group applied for a new loan from American Security Bank. At that time, documents exchanged between JLM Group and American Security stated that the purpose of the loan was to “refinance” or “retire” the Dominion debt.

The terms being offered by American Security were very favorable: interest at 10.25% (as opposed to 13.25% on the Dominion loan), lower monthly payments,

and a reduced loan guarantee requirement at \$5,500,000 (compared to guarantor liability of \$14,500,000 under the Dominion loan). The maturity date, March 1990, would remain the same.

But by the time the new loan transaction was set to close, the parties' stated purpose had changed. Instead of a refinancing, the new loan was being made in order that American Security might purchase and take an assignment of the Dominion notes and deeds of trust.

The new loan transaction closed in May 1986. At the time, less than 80% of the \$14,500,000 had been funded by Dominion. However, in order to give JLM Group a fixed rate of interest for the entire \$14,500,000, American Security funded the total amount at once into a new bank account to be managed by American Security, which was titled “ASB Loan Escrow Account for JLM Group Ptnrs.” JLM Group did not have signature authority over this escrow account.

On the day the escrow account was opened about \$11,600,000 was transferred via the settlement agent to Dominion, representing the Dominion loan balance plus

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Courts Illustrated

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edge of a competing claim of interest in the same property. Such a "b.f.p." acquires title free of the competing interest.

Section 544(a)(3) is sometimes called the "trustee avoiding power," because it allows trustees (and debtors-in-possession) to avoid interests in a debtor's real estate which are not perfected as of the date of commencement of bankruptcy.

Midlantic filed an adversary proceeding seeking to establish its mortgage as a first lien. The lender argued that at the time bankruptcy was commenced its unrecorded mortgage was at least an equitable lien, and it should be entitled to its original priority since all loan proceeds secured by the

unrecorded mortgage were used to satisfy the original mortgage. Had the original mortgage not been satisfied when the bankruptcy was filed, the trustee would unquestionably have taken title to the property subject to Midlantic's first mortgage.

The bankruptcy court ruled in favor of the trustee, and the federal Court of Appeals for the Third Circuit affirmed the decision.

The Court of Appeals first decided that the law of the State of New Jersey should be applied to determine (1) whether Midlantic was entitled to an equitable lien, and (2) if so, whether the legal doctrine of equitable subrogation would operate to place Midlantic in the first lien position as of April 3, 1987.

Applying New Jersey law, the Court at

first agreed that Midlantic should be entitled to an equitable lien. However, in spite of the fact that Midlantic's original loan proceeds paid for the very improvements which gave the property its substantial value, the court held there were insufficient grounds for Midlantic's unrecorded mortgage to be equitably subrogated to the priority enjoyed by the original mortgage. In so holding, the Court relied on a literal reading of § 544(a)(3), and a very dim view of lenders who fail to cause their security instruments to be promptly recorded.

All said and done, Midlantic became just another unsecured creditor in the Bridge bankruptcy.

The official citation is *In re Bridge*, 18 F.3d 195 (3d Cir. 1994).

postings . . .

New in Print

For those who may think "cloud on title" refers to a weather condition, the Mortgage Bankers Association of America has a new publication titled *Mortgage Banking & Title Insurance*.

This 62-page handbook describes the role of title insurance in mortgage banking, as well as the part played by lenders in shaping policy coverages. Included are detailed explanations of all standard title policy provisions, along with discussion of such topics as survey coverage, endorsements, the concept of marketable title, and the pitfalls in accepting deeds-in-lieu of foreclosure. An entire chapter is devoted to "Title Protection in Commercial Transactions." There's also a 10-page Glossary.

More than two years in the making, this publication was written and developed by the American Land Title Association.

Copies are available from the MBA at 1125 15th Street, N.W., Washington, DC 20005-2766. The cost is \$35 each for MBA members, and \$45 each for non-members, plus 10% handling charge.

Also now available is the latest edition of Robert Duff's *Buyer, Seller and Re-Finance Guide*. This 48-page handbook is offered as a basic reference tool for those who may be new to buying, selling or investing in real property.

The Guide covers such diverse topics as tips for the home buyer or seller, the role of escrow and the escrow holder, refinancing, typical lender requirements, types of loans (conventional, V.A. and F.H.A.) and types of home ownership (single family detached, planned unit development, condominium, stock cooperative, etc.).

Common loan terminology and concepts, such as "points" and the mortgage rate buy-down concept, are explained in detail. Also explained are the homeowners' association, real estate and supplemental taxes, capital gains tax exemption rules for homeowners 55 years of age and older, and the importance of title insurance for the property owner.

A special section covers the advantages of using a professional realtor/broker.

Mr. Duff, a senior vice president of First American Title Insurance Company, has published the Guide since 1973. Copies are available at \$5 each (plus \$.50 handling) from R.W.D. & Associates, P. O. Box 1242, Santa Ana, California 92702. Quantity discounts are available.

A.M. Best Issues First Title Insurer Rating

A.M. Best Company's first-ever rating of a title insurer has been assigned to First American Title Insurance Company, principal subsidiary of The First American Financial Corporation. The Company and its subsidiaries received a rating of "A" from the nation's foremost insurance rating

agency.

As stated in A.M. Best's rating report, the "A" (Excellent) rating "reflects the consolidated operating performance and financial condition of the ten title insurance companies that form First American's group. The rating reflects the group's strong financial performance, operating strategy and strong capitalization."

According to A.M. Best, "the company has demonstrated a pattern of growth and profitability even during periods of economic downturns with a remarkable history of growth in market share which has grown from 12.2% in 1985 to 19.2% in 1995. This fact is underscored by the last 10 years of operation wherein the company's revenues have grown by an average of 18.4% per year. This significantly exceeds the industry 11% average annual revenue growth.

"The key elements of the company's steady increase in revenue are: management philosophy, mix of business, products and services, and market share gains," the article continues. "In addition, the mix of related real estate products and services (through the holding company) allows for the diversification of revenue to offset fluctuations in the core business and provides a revenue stream to support holding company operations and contribute to insurance operations."

Ratings by third parties have become increasingly important to many title insurance customers, particularly commercial/industrial lenders and developers. This rating from A.M. Best provides objective support for

Pick-Off Play

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prepayment penalties, and the escrow account was debited \$145,000, representing a loan origination fee payable to American Security.

Also at the May 1986 closing, JLM Group executed a "Replacement Promissory Note" in favor of American Security in the amount of \$14,500,000, and a "First Amendment, Restatement and Consolidation of Deeds of Trust, Assignment of Rents, and Security Agreement." The latter document, which the parties referred to as an amended deed of trust, recited the continuing existence and validity of the Dominion notes and deeds of trust, restated the priorities of Dominion's liens on each parcel, and provided that the amended deed of trust "shall be entitled to the same lien and priority as the Original Deed of Trust."

After closing, First American amended its title policy, by endorsement, now insuring American Security as lender by virtue of the assignments, and also insuring against loss of first priority due to modification of the deeds of trust.

One problem with all of this was that the sellers, holding second and third deeds of trust on the motel parcel only, weren't asked to consent to the new loan. And, apparently, they weren't pleased with alterations done on the motel.

When JLM Group defaulted on its loans, and American Security threatened foreclosure, the sellers filed a lawsuit seeking to establish priority for their deeds of trust as against American Security. The sellers argued that American Security could not succeed to the priority status of Dominion because the Dominion loan was satisfied with funds which were the property of JLM Group, resulting in satisfaction and extinguishment of the Dominion debt. It follows, they reasoned, that the amended deed of trust given to American Security should be junior to the previously recorded deeds of trust in favor of the sellers.

The sellers also claimed that essential conditions upon which they originally agreed to subordinate to the Dominion loan had been violated. Specifically, it was originally agreed that Dominion would enjoy first priority status on both parcels, to the extent of \$8,000,000, provided that

improvements to the existing motel allowed it to "remain intact as a self-contained operating facility capable of providing to guests the services which are now available."

At trial, one of the sellers testified that the original motel property included a free-standing registration building and sign, as well as a banquet room which, he noted, was essential to attract large groups to the motel. Apparently, both before and after the American Security loan closed, work proceeded to demolish the registration building and sign, and the banquet room was converted to a registration area.

The trial court ruled in favor of American Security, and the case was appealed to the Virginia Supreme Court. Sixteen months later the Supreme Court affirmed the trial court ruling, finding insufficient evidence to support the claims of plaintiff sellers.

The Court found that the American Security transaction was, in fact, done as an assignment. All of the documentation generated through closing evidenced an intention by the parties to assign the Dominion loan. The establishment of the escrow account was deemed important because it placed the new loan proceeds beyond the immediate control of JLM Group, whose later access to the funds was restricted "to a degree inconsistent with ownership." In fact, the Court concluded that it was American Security and not JLM Group which paid the \$11,600,000 to Dominion.

Throughout its decision, the Court stressed that it saw no prejudice to the sellers in the way the new loan transaction was structured. The amount secured as a first lien remained at \$8,000,000. The lower interest rate and monthly payment allowed by the American Security loan were advantageous to JLM Group, and couldn't have prejudiced any interest of the junior lienors (sellers).

Likewise, the Court said there was no evidence that alterations to the original motel had diminished its value, or damaged sellers' security interests.

Pointing out that the

conditions of subordination were neither recorded nor otherwise made known to American Security, the Court held that "in the absence of fraud or collusion" American Security would not be liable for violation of those conditions.

First American paid legal expenses of \$271,000 in the successful defense of its insured lender.

MORAL: Endorsements insuring validity of assignments and enforceability of loan modifications are made available by title insurers in most states.

Subordinated or "junior" parties are understandably sensitive to perceived changes in the status of senior liens, especially in a declining real estate market or in the case of a troubled project. They may view such changes as an invitation, or at least an opportunity, to challenge a senior party's priority.

The courts, too, are very interested in protecting the rights of junior parties in real estate transactions. Almost any perceived unfairness to the legitimate interests of a junior party can be expected to find a judicial remedy.

Priority disputes usually produce a complicated mix of factual and legal issues which can be baffling to a judge or jury. They can be difficult and expensive to defend, and final outcomes can be unpredictable.

In any proposed workout or loan modification, lenders and title underwriters need to be mindful of the concerns of junior parties, and avoid situations where the lender might be accused of unfairly helping itself to the detriment or prejudice of junior interests.

