The State Of Marketable Title

By S.H. Spencer Compton
Senior Vice President and Special Counsel
First American Title Insurance Company of New York

What is the state of marketable title today? It is like the state of Kashmir. In India. Or is it in Pakistan? In any discussion, various factions claim competing interests. Both "marketable title" and "unmarketable title" are slippery academic concepts generally without practical day-to-day application. It is likely that the issue will arise only when a buyer is trying to back out of a contract of sale and attorneys must evaluate the claim. Case law provides an often contradictory and certainly convoluted patchwork quilt of cases, which go off in many directions. Where to begin?

Definition

The ALTA owner's and lender's policies provide (on the first page of the policy) coverage (subject to the policy exclusions and exceptions and conditions and stipulations) "against loss or damage, not exceeding the Amount of Insurance stated in Schedule A, sustained or incurred by the insured by reason of: . . . 3. Unmarketability of the title."

The ALTA 1992 form policy defines "unmarketability of the title" as:

"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."

A circular definition at best, but one that establishes the conditions under which a marketability issue will be considered covered under the policy and, therefore, ripe as a claim of loss or defense. A claim is ripe if title is encumbered by an "alleged or apparent" defect. Note that there is no requirement to prove that the defect is real. Further, a claim is covered only if it is "not excluded or excepted from coverage." No matter how severe an effect the defect has on merchantability of title, there is no coverage for any defect disclosed by or excluded from the policy.

That said, judicial interpretation--state law--determines what does and does not constitute unmarketable title such that a purchaser could be released from its obligation to buy.

State Law

The Marketability Section of Warren's Weed New York Real Property contains a daunting list of cases with fact patterns that may or may not match the circumstances with which the client is faced. This article, and, for that matter, life, are both too short to discuss them with any breadth. Although the more subtle aspects of marketability are sometimes contradictory, a number of similar elements frequently appear and are useful as a sort of baseline. Here are a few examples:

Every contract implies an obligation to convey a marketable title. Laba v. Carey, 29 NY2d 302, 327 NYS2d 613.

Voorheesville Rod and Gun Club, Inc. v. E.W. Tompkins Co. Inc., 82 NY2d 564, 606 NYS2d 132 .

and:

(Marketable title is) title that is free from encumbrances and free from reasonable doubt. Crocker Point Ass'n v. Gouraud, 224 NY 343.

and:

A marketable title is free from reasonable doubt, but not from every doubt. Voorheesville Rod and Gun Club, supra.

What Constitutes Unmarketability of Title?

There need not be an "adverse claimant" in order to raise an unmarketability claim under the title policy. The mere possibility of a "cloud" on title, sufficient to justify a potential buyer or lender in declining to buy or lend on the property, is enough to trigger coverage under the policy. However, the ALTA title-policy coverage for unmarketability of the title applies only to those unmarketability claims resulting from title defects. Unmarketability problems relating to the use of the property are not ordinarily covered by the title policy. For example, off-record environmental contamination is not a risk covered by the insuring provisions of the standard title insurance policy. Such contamination is not a "defect, lien or encumbrance," and is not a matter affecting marketability of title.

Unmarketability of title is not necessarily the same as reduction in market value. The insured may suffer a loss, when selling or mortgaging a property as a result of a title defect that was not discovered or disclosed in the original title search, that cannot be adequately measured by (as set forth in Section 7(a) of the Conditions and Stipulations of the title policy for calculation of loss) "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." For example, if the buyer of a property refuses to purchase it because the seller is unable to deliver title in the condition specified in the purchase agreement, the loss to the insured triggered by the inability of the seller to convey the property in the condition agreed to may be different than a loss otherwise incurred by the insured after the closing.

All policy exclusions, exceptions and conditions apply to limit the policy's coverage for unmarketability. Accordingly, even when a policy covers loss resulting from unmarketability of the title, the policy's exclusions and exceptions may preclude a right to indemnification for certain title defects that exist and, in fact, make the title unmarketable.

Although, for the most part, unmarketability of title can best be defined by a list of fact-specific state law holdings, there are certain obvious defects which most will agree render title unmarketable.

A forgery in the chain, for example, would make the title unmarketable because the last owner of record is not the true owner if a predecessor's signature was forged on a deed of conveyance.

Similarly, where there is an unexplained break in the chain, there is a question as to who has the better title: the owner of record prior to the break or the current record owner.

Titles have been rendered unmarketable due to a recital or other evidence, set forth in a recorded deed in the chain of title, which suggests or may be taken to impute notice of the existence of some outstanding interest under an unrecorded instrument. A deed, for instance, may describe a parcel of land but except from it, without specification, premises which have been previously conveyed. Fortunately, several statutes have been enacted—New York Real Property Law ("RPL"), Section 291e, for example—which makes such an indefinite reference void as against bona fide purchasers without notice and, more importantly, ineffective to give notice. Similarly, an improper or incorrect acknowledgement on a deed makes title unmarketable, but if the deed has been of record for ten or more years, by statute in New York, the title defect is a nullity (RPL, *Section 306*).

A mortgage lien, not expressly provided for in the contract of sale, renders title unmarketable. That the purchaser had knowledge of the mortgage is immaterial. The purchaser may assume that the seller will convey title free of the mortgage. Where the contract of sale expressly provides that the purchaser will take title subject to a specified mortgage, the purchaser is then charged with knowledge of its terms and cannot object to the existence of the mortgage so long as its terms conform to those set forth in the contract. A mortgage open of record does not render title unmarketable if the seller has a release document.

An unexpired lease in existence on the date of closing title makes title unmarketable. It is critical, therefore, that any provision in the contract making the sale subject to tenancies be carefully articulated because its omission or vagueness, in the face of tenancy, offers the purchaser an easy way to walk away from the contract with its purchase deposit intact.

Brokers

A broker is entitled to a commission from the seller even though the transaction fails to close due to unmarketable title.

Lender's Policy

In a loan policy, the "unmarketability of title" insuring provision covers the lender against title-related claims that actually disable or prevent the lender from selling its mortgage to another investor, or that would require the lender to repurchase a mortgage. Again, this language does not cover circumstances resulting from physical condition of the land, such as contamination with hazardous waste or damage to improvements.

Encumbrances

An encumbrance is a burden or charge on the property or an outstanding right in a third party, which interferes with the use or transfer of the property or subjects the property to an obligation. As a general matter, any encumbrance renders title unmarketable. Furthermore, where a property is subject to an encumbrance, title is unmarketable, despite the improbability of any adverse effect on the title or use of the property. A case in point: there was a property which was served by electric wires in the abutting street and was subject to an easement permitting the maintenance of poles and wires across the property. The court deemed the unlikelihood of any use of the easement immaterial. The existence of the easement rendered title to the property unmarketable.

Encroachments, both on and off the property, can render title unmarketable. That said, encroachments by roof cornices, trim, fire escapes, cellar doors and the like do not ordinarily discourage a willing purchaser even though title has been rendered technically unmarketable.

A jurisdictional defect in the court action from which the title is derived can render a title unmarketable. An example of this is where a foreclosing mortgagee fails to give the required notice to the defaulting mortgagor/fee owner. Similarly, a conveyance while a bankruptcy stay is still in effect is a violation of Federal Law (11 USC 362), which will make title unmarketable.

An easement in front of a property for an elevated railway renders title unmarketable. Monogram Development Co. v. Naben Construction Co., 253 NY 320.

Restrictive covenants affecting intended use, i.e., no slaughterhouse, distillery, tallow chandlery, smith shop, etc. render title unmarketable. Mauser v. Friesco Realty Corp., 245 NYS2d 42.

Restrictive covenants affecting lot area, i.e., limitation on the portion of the lot on which construction may take place render title unmarketable. Friedman v. Handelman, 300 NY 188.

Threat of litigation or substantial expense, i.e., potential demand for the removal of encroachments renders title unmarketable. Dukas v. Tolmach, 153 NYS2d 392.

Nonetheless, even though a covenant might render a title unmarketable, with affirmative title insurance, a purchaser will likely accept such a title. This is the distinction between marketable and insurable title, discussed below.

Surveys

Unresolved conflict between two surveys renders title unmarketable. Wates v. Crandall, 144 NYS2d 211. Here, two competent licensed surveyors came up with different results originating from different locations of a 1907 fence location. This case also stands for the proposition that even if a de minimis amount of the land to be conveyed is in question—one half of one per cent of the total area was questionable in this case—title to the entire parcel may be unmarketable.

Where a survey defect is not of record, but could have been identified if a survey had been made and submitted to the title insurer, the title insurer may be liable to the insured for a claim of unmarketability of title based on the undiscovered or undisclosed survey defect. Since the policy does not limit coverage to record matters, the title insurer must either take a general survey exception, or examine the survey and take specific exception to the items shown on the survey. If the title insurer takes specific exceptions, but misses a matter that should have been excepted and does not show it as a specific exception (such as an encroachment), the title insurer could incur liability under the "unmarketability of title" coverage provision if the buyer repudiates the contract because it has discovered the defect and refuses to close the transaction.

Drafting

When drafting the provision in the contract of sale describing the condition of title to be delivered at closing, the seller's counsel's goal is to be as inclusive as possible. The following language contemplates a broad universe of facts: "Subject to any state of facts shown on the [annexed] survey prepared by _________________, dated ________ [and last redated _______] and to any additional state of facts an accurate survey or personal inspection of the property would disclose." In response, the purchaser's counsel, seeking to protect its client by narrowing the forgoing, might wish to add: ", provided such additional facts do not render the condition of title to be in violation of this contract." The reference is to the earlier contract provision where the seller has covenanted to deliver either a marketable or an insurable title, as the case may be.

Marketable Versus Insurable Title

Marketable title and insurable title are not the same. Title insurers will ignore certain defects in title for a variety of reasons, which is what title underwriting is all about: risk evaluation. It follows, then, that the test of marketability is not that a reputable title insurer has issued a policy free of the defect in question. Title is also not rendered marketable by the insurer's willingness to issue a new policy to a purchaser from the insured. Nonetheless, an insurer's willingness to insure is frequently used as a yardstick – a litmus test – for marketability.

An insurable title is "one which a reasonably prudent title insurance company would be willing to insure, free from exceptions (other than those normally excluded by the policy form) and at normal title insurance rates." James M. Pedowitz, "Marketable Titles" in Real Estate Titles, 2nd Edition, (1998) at page 24-21. In short, an insurable title is one for which a title underwriter (or its agent) decides to issue a title insurance policy. It's that simple. Whereas, ideally, a marketable title is one free of liens, encumbrances and defects, an insurable title is not necessarily a perfect one.

A title insurer, for any number of underwriting reasons, may elect to "insure over" or "omit" a defect which, under a pure marketability of title analysis, would render title unmarketable. A typical example of this is where a property is encumbered by the lien of an open mortgage, which has not been released or satisfied of record. Under the classical marketability analysis, such a title would be unmarketable, but, so long as the title insurer has received satisfactory evidence that the mortgage was paid in full, the insurer will insure over the mortgage and omit the title defect.

A title insurer may not always be willing, nor is it required, to insure a title even where that title is marketable. In Title Guarantee & Trust Co. v. Rudershausen, 164 N.Y.S. 15 (Sup. Ct. App. Term 1917), a title company refused to insure a title that had been determined by court order to be marketable.

Nor does an insurer's refusal to insure render title unmarketable. Wilson v. Pacific Coast Title Ins. Co., 235 P.2d 431 (Cal. App. 1951). A title insurance company cannot be compelled to issue a title insurance policy. It is free to conduct its business in the manner it chooses.

Clearly, an insurable title is of a lesser quality than a marketable title, but in the real world of commercial real estate transactions, that distinction is misleading. Few conveyance or loan transactions close unless and until the title insurance company is prepared to issue its policy. Having an insurable title is far more important in the world of commerce than having a technically marketable title. As a practical matter, an insurable title is often a lot easier to come by than a marketable one.