New Jersey Law Journal

VOL. CLXXII – NO. 11 – INDEX 1059 JUNE 16, 2003 ESTABLISHED 1878

Real Estate & Title Insurance

Title Companies Must Be Prepared To Litigate

Competition and New Jersey jurisprudence have compelled title companies to view litigation as a cost of doing business

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The complexities of living and conducting business in the United States, and in particular, states rich in industry and commercial activity such as New Jersey, have dramatically altered the business model of for-profit professionals in recent years. The legal community, and ancillary ventures such as title companies, have not been spared from the domino effects of this change.

Title companies now are confronted with compelling decisions on how to compete and survive in an industry where growth and litigation exposure are a package deal. To better appreciate the economic present, historical background on the title industry is instructive. (See *Title Resources Guaranty Company, A Brief History of the Title Insurance Industry*, 1996.)

Title Insurance and Its Origins

Modern legal history, from as early as the 1800s, demonstrates that purchasers of real property frequently consulted an attorney for advice concerning the quality of title to real estate. A lawyer's legal opinion became more routine, and ultimately a de facto requirement, when the source of purchase money flowed from a disinterested lender.

The logical progression of this relationship eventually resulted in the query, "Who is responsible if the lawyer makes a mistake?" This question was answered by the creation of title insurance, thereby providing a remedy for both buyers and lenders.

For a fee, an assurance of title or indemnification of loss caused by errors in the evaluation of the quality of title was born. See "Title Insurance: State Regulation and the Public Perspective," 39 Ind. L. J. 1, 5-7.

The only type of insurance originally developed in the United States, title insurance is unique in that it is not a child of the English system of jurisprudence. See Davenport, "Title Insurance," 1 Examination of Insurance Companies 309 (N.Y. Ins. Dept. 1953). The Law and Property Assurance Society of Pennsylvania, circa 1853, is believed by many to be the first company to offer insurance for defects in title and guarantees for debt service. See Francis, Annals of Life Insurance 291 (1853). Following the seminal decision in *Watson v. Muirhead*, 57 Pa. 161 (1868), which established the tort liability for an erroneous abstract, in 1871 the Title Warranty Company of Pennsylvania drafted a business plan for insuring titles and mortgages. See 1 Joyce, Law of Insurance 59 (1917).

Greeted with skepticism from the onset, commentators sensitive to consumer protection have historically warned that title insurance, from its very genesis, was designed to insulate abstractors and lawyers as opposed to providing protection for the insured. See E. Roberts, et al., *Public Regulation of Title Insurance Companies and Abstractors 1* (1961).

The Lawyers' Title Insurance Corporation was created following enactment of enabling legislation throughout the northeast, commencing with the 1874 Pennsylvania laws. In the decade thereafter, title insurance companies opened their doors in most of the major cities on the East Coast.

Title insurance, both as a product and as an industry, attempted to secure market share away from the land registration systems that dominated the need for assurances during the early 20th century. Up through the early 1920s, numerous states used a Torrens land registration system. See *American Conveyancing Patterns* 108 (1978).

The title industry made great strides during the years spanning the First and Second World Wars. The crux of the industry's success was convincing lenders that title insurance was a necessary cost of doing business for the development and finance of residential

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properties. See "The Problem of Land Titles," 44 Pol. Sci. Q. 421, 430-431 (1929).

Reliance upon title insurance was amplified through the federal government's immersion in the residential housing markets of the 1930s as loan terms increased and interest rates decreased. By the early 1940s, title insurance was the preferred type of title assurance for residential transactions and did not lag far behind as the preferred title assurance for commercial transactions as well. See "Title Insurance: A Primer for Attorneys," 14 Real Prop. Prob. & Tr. J. 608 (1979), and "Commercial Title Insurance and the Lawyer's Responsibility," 15 Real Prop. Prob. & Tr. J. 557 (1980).

Title companies must figure out how to compete and survive in an industry where growth and litigation exposure are a package deal.

The post-World War II housing boom vastly expanded the use of title insurance. The American Land Title Association standardized the policy forms in conjunction with attorneys and governmental organizations, including the Federal National Mortgage Association — or Fannie Mae. Congress created Fannie Mae in 1938 to strengthen the sagging post-depression housing industry. Fannie Mae became a private company in 1968 and is currently a publicly-traded company that buys mortgages on the secondary market, then sells them as securities to investors.

The emergence of organizations such as Fannie Mae served both to stimulate business and to standardize the basic forms of coverage in most states. The ALTA worked closely with lender counsel groups to develop the most popular policy form: the ALTA Loan Policy.

In New Jersey, it is common practice in a simultaneous purchase/mortgage transaction to insure both the owner (contract purchaser) and, for a nominal issuance fee, the lender. In many other states the mortgage policy is not written for a nominal charge, rather, a full premium must be paid for both the owner and lender's policy.

In 1989, the title industry reported revenue receipts exceeding $3.8 billion, generated via policy premiums written in the 50 states. See Corp. Dev. Services, Inc., Performance of Title Insurance Underwriters, 55 (1990).

Regulation of the Title Insurance Industry

As with most insurance and surety relationships, the interests of the public mandate security for title insurance policyholders, which security was historically defined as assurance of sufficient reserves in relation to premium receipts. This safeguard aids in fulfilling a contract of indemnity when the insured incurred loss. Thus, title insurance is subject to review and investigation by the New Jersey Department of Banking and Insurance.

New Jersey, as with most states, regulates the issuance of title insurance on real property located within its borders by licensing insurance carriers, as distinguished from agents, both domestic and foreign. In 1995, the National Assoc-iation of Insurance Commissioners adopted a revised Model Title Insurance Agents Act and a companion model Title Insurers Act. New Jersey's governing statute, however, is not based on the NAIC model.

The statutory authority governing the operations of title insurance companies in New Jersey, The Title Insurance Act of 1974, is found at N.J.S.A. 17:46B-1 et seq. The act regulates the formation and licensure of title insurance companies, title insurance rates, applicants and agents for title insurance, and prohibits title insurance agents from practicing law. The act also prohibits mortgage guarantees.

A primary tool of such regulation is to require insurance companies and their agents to rely upon authorized forms approved by the New Jersey Department of Banking and Insurance. In New Jersey, no one government agency standardizes the title insurance policy forms. Every title company must submit its proposed policy forms and other contracts to the Commissioner of Banking and Insurance. The commission reviews each form and rejects those forms that conflict with New Jersey statutes. N.J.S.A. 17:46B-54.

Many jurisdictions restrict the issuance of title insurance companies by a carrier to a "single line," precluding an agent from selling to the public insurance unrelated to title insurance. According to The Title Insurance Act, New Jersey is a single line state, restricting licensed title insurance companies from selling any other type of insurance to the public and restricting all other entities except title insurance companies from underwriting or issuing title insurance policies. N.J.S.A. 17:46B-5; N.J.S.A. 17:46B-12.

This legislative limitation is frequently the target of lobbying efforts to loosen control, however, the insurance industry has been unsuccessful as of date in such efforts.

Title insurance is a unique form of insurance in that it seeks to prevent a loss prior to the issuance of the policy. This procedural anomaly differs from most other insurance products that anticipate loss as the foundation of the underwriting process.

This distinction is most easily appreciated by understanding the search process and the tasks performed by a title searcher. Those who purchase title insurance buy only one policy and do not need to obtain a renewal. Therefore, New Jersey isolates title insurance companies and underwriters in this self-contained statute.

All states, including New Jersey, now prohibit the transaction of title

insurance without a license. N.J.S.A. 17:46B-25. Others, also including New Jersey, prohibit title companies from the practice of law and conveyancing. N.J.S.A. 17:46B-11.

In order to admit and authorize title insurance carriers to do business here, New Jersey requires them to be licensed to insure titles to real estate. N.J.S.A. 17:46B-25.

The Claim Process

As consideration and in exchange for payment of a premium regarding an ordinary real estate purchase, a carrier typically supplies the insured and the lender with a contractual promise to defend and to indemnify the risks identified in the policy and which are not excluded by the ALTA Schedule IIB Exclusion Schedule.

The title insurance policy typically mandates that once an insured is on notice of facts which should reasonably lead to a conclusion that a claim exists, the insured must notify the company within a prescribed period of time. See Section 3 of ALTA Form 1992, "Conditions and Stipulations."

Failure by the insured to timely notify an agent or carrier (typically within 90 days) may operate to deny coverage if the insurer can establish prejudice in its ability to defend against the claim or otherwise cure the defect. See *Costagliola v. Lawyers Title Insurance Co.*, 234 N.J. Super. 400 (Ch. Div. 1988). The notice requirement in title policies remains a common, universally shared safeguard in most insurance products.

New Jersey courts have held that a carrier is contractually obligated to cure a defect, versus a narrower obligation giving a carrier the right to cure. See *Summonte v. First American Title Ins. Co.*, 180 N.J. Super. 605, (Ch. Div. 1998).

Although it is common practice for a title insurance carrier to commence negotiations to remedy a claim, once litigation is embraced, the most common procedural vehicles are: (1) an action to quiet title, N.J.S.A. 2A:62-1 et seq.; (2) a declaratory judgment action, N.J.S.A. 2A:16-50 et seq.; and (3) an action in ejectment, N.J.S.A. 2A:35-1 et seq.

The State of New Jersey must often be made a party to an action due to some right, title, claim or other interest — that is, an inheritance tax lien, N.J.S.A. 54:35-1 — with service of process upon the attorney general.

Trends & Risks

In recent years, title insurance law has seen national trends in the litigation of insuring provisions, exclusions from coverage and the application and construction of standardized title insurance policy language. See "Recent Developments in Title Insurance Law," 36 Tort & Ins. L. J. 605 (2001).

Closer to home, New Jersey attorneys and real estate service providers have been warned to curtail certain common practices that may subject them to litigation and penalties from the Department of Banking and Insurance. In the post-Sept. 11 economy, attorneys, realtors, mortgage brokers and title agents all seek to generate new business and to service existing clients by quid pro quo referrals.

Some common practices include the expenditure of funds by title insurance agents or "producers" to entertain clients and other individuals who channel business to the agency (see Banking and Insurance Bulletin #97-14); payment of a room rental fees to real estate brokers (see Banking and Insurance Bulletin #99-08); title insurance producers offering real estate transaction work to attorneys (see Banking and Insurance Bulletin #02-29); and title insurance producers placing attorney's names on a "recommended attorney list" provided to purchasers of title insurance in exchange for referrals of such purchasers (see Banking and Insurance Bulletin #02-29).

These common practices take on an ominous appearance in light of the department bulletins, which warn against inducements and the connected activities which are prohibited. This quid pro quo practice of referring legal work in return for title insurance orders or other inducements may violate the Title Insurance Producers Act, N.J.S.A. 17B:46B-1 et seq., which precludes title insurance companies or agents from giving inducements in exchange for title insurance orders.

Is it more dangerous to give inducements than to receive them? Not according to the Department of Banking and Insurance, which interprets N.J.S.A. 17:46B-34, -35 and -35c as outlawing not only the offer of such inducements or special favors, but the acceptance of or agreement to them as well. See 171 N.J.L.J. 984.

Despite proposed federal changes, attorneys and other real estate service providers are governed by the New Jersey laws which conflict with the federal proposals and which threaten to penalize those who ignore the prohibitions with penalties with up to five times the amount of any inducement or consideration accepted. N.J.S.A. 17:46B-37.

Title companies have expanded their scope of services due to legislative changes, that is, searches required by the USA Patriot Act (Executive Order # 13224) and competition driven pressures to increase or maintain market share. It is the latter development that has expanded the types of lawsuit that routinely involve title companies, whether carriers or agents, as named defendants — actions that do not focus on policy language construction.

Take for example the case in *Cider Press Homeowners Association, Inc. v. Congress Title Division*, A-2600-00T1 (May 13, 2002). In *Cider Press*, a dispute arose regarding an allocation of fault due to an alleged failure to record certain declarations and covenants in the Gloucester County Clerk's Office. Claims brought on behalf of the plaintiff homeowner's association included a cause of action that the defendant title company owed and breached a duty to effectuate recordation.

While rejecting the plaintiff's claim, the Appellate Division did articulate that in addition to contractual obligations via a policy of title insurance, a title company may be liable for breach of a duty imposed by virtue of a "voluntary assumption" of a task. See also, *Walker Rogge, Inc. v. Chelsea Title & Guar. Co.*, 116 N.J. 517 (1989).

More troubling for the title insurance industry is the derivative limitation on a carrier's ability to seek recourse due to acts by those not under

the title company's control or influence.

In June of 2002, the New Jersey Superior Court, Appellate Division, decided another issue-of-first-impression case that, if not reversed, presents a new challenge to title companies and the carriers they write for — evaluating the quality of the law firm or lawyer relied upon in a run-of-the-mill real estate transaction.

In *First American Title Ins. Co. v. Lawson*, 351 N.J. Super. 407 (App. Div. 2002), the claims of two title insurance carriers for coverage under a professional liability insurance policy covering a "closing" attorney failed when the court rescinded the malpractice policy due to a closing attorney's misrepresentation in the application process.

The *First American* decision has generated great insecurity in the legal community as an insurer's ability to deny coverage to a law firm, in toto, appears within grasp based solely on one partner's malfeasance or intentional wrongdoing.

Lawyers, however, hold no monopoly on the fear that the *First American* court has fanned. Title insurance, from an underwriting perspective, computes as a collateral source of recovery the policy proceeds afforded to a closing attorney should a transaction go awry.

Can a title company and its host carrier continue as a for-profit entity when a primary asset previously available to satisfy a claim is at risk via the acts or omissions of an attorney uninvolved in a transaction, yet who is a distant member of a closing attorney's firm? ■