CLAIMS AWARENESS

HOT SHEET

A publication by the California Land Title Association's Claims Awareness Committee

Title Insurance and the Concept of Marketable or Merchantable Title

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Marketable title is one of the more difficult title insurance coverage concepts to grasp because it seems to conflict with the common sense usage of the term "marketable." Virtually all title insurance policies provide coverage against the loss and damage associated with unmarketable title and each policy and version of a particular policy has its own definition of unmarketable title. The ALTA Loan Policy (6-17-06) jacket defines an unmarketable title in the following fashion:

> *(m) "Unmarketable Title": Title affected by an alleged or apparent matter that would permit a prospective purchaser or lessee of the Title or lender on the Title or a prospective purchaser of the Insured Mortgage to be released from the obligation to purchase, lease, or lend if there is a contractual condition requiring the delivery of marketable title.*[1]

Two words in this definition "title" and "marketable" provide the key to the confusion surrounding the concept. When one uses the word market in a financial context, he thinks of the stock market or the real estate market. Both of these markets revolve around the concept of value. What is the price of the stock? How much is the parcel of real property worth? But marketability in the context of title insurance is not a value concept. It relates to the condition of Title (with a capital T) that is the subject of the insurance.

A 1951 California Supreme Court case, *Hocking v. Title Insurance and Trust* (1951) 37 Cal. 2nd 644, 651 sets this proposition forth in axiomatic form: "One can hold title to land that is valueless; one can have marketable title to land while the land itself is unmarketable."

The plaintiff in *Hocking* purchased two unimproved subdivision lots in Palm Springs. The developer had failed to comply with a city ordinance which required the posting of bonds and agreements for paving and grading the streets in the subdivision before recording the map. The plaintiff alleged that grading and paving expenses would be in an amount in excess of what she had paid for the lots. She stated that without the bonds which would get the streets paved in place she really did not have title to subdivision lots.

The California Supreme Court disagreed. It said that the failure of the developer to comply with the city ordinance impaired the value of the lots but did not make them unmarketable. The court said that she had fee simple title to the lots for whatever that was worth and that if she had been damaged by false representations she needed to turn to the party who had made them not the title insurer. Marketability applied to the title to the lots which was not impaired not their value which was.[2] She had marketable title to the lots even though it was improbable that she could sell or develop them with graded and paved streets.

Hocking is in accord with an earlier case, *Nishiyama v. SAFECO Title Insurance Company* (1978) 85 Cal. App. 3d Supp 1. The plaintiffs argued that the property had been subdivided in violation of the California Subdivision Map, CA Government Code § 66499.30 et. seq. and that non-compliance with the Act made the property unmarketable. The sellers had not been aware of the violation. But the policy contained an exclusion from coverage for failure to comply with governmental regulations, and ordinances. The vio-

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1 ALTA 2006 Loan Policy

2 *Hocking v. Title Insurance and Trust* (1951) 37 Cal. 2d 644,651

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Appellate Victory: Escrow Holder is not Liable for Interpleading Escrow Deposit on Cancelled Transaction; Attorney's Fees and Costs Awarded to Title Company

by Lori Hershorin
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The seller ("Seller") entered into a real estate purchase agreement ("Contract") with the buyer ("Buyer"). The title company ("Title Company") served as the escrow holder pursuant to its own escrow instructions. The Title Company was not a signatory to the Contract.

Buyer made a $50,000 deposit ("Deposit") into escrow, but thereafter the Buyer cancelled the transaction and requested the return of the Deposit. Seller refused to sign mutual cancellation instructions to release the Deposit to the Buyer. After the Title Company waited several months for the Buyer and Seller to resolve their dispute, attorneys were retained to interplead the Deposit. In response to the Interpleader Action, the Seller first informed the parties that the Deposit should not be released to the Buyer. The Seller thereafter contended that the Title Company breached the Contract by failing to release the funds to the Buyer. The Buyer and Seller both argued that the Title Company was a party to the Contract, even though it was not a signatory, because the Contract referenced the escrow.

The Title Company prevailed in the case on a motion for summary judgment. The Title Company argued that it was not a party to the Contract and that mutual cancellation instructions signed by both parties were required for the release of the Deposit to the Buyer. The Court found that the Title Company was not a party to the Contract, and that it had acted prudently by refusing to release the Deposit to the Buyer in light of the Seller refusing to sign mutual cancellation instructions.

After prevailing on the Motion for Summary Judgment, the Court granted the motion for attorneys' fees and costs against the Seller and Buyer under Civil Code §1717. The Title Company argued that California law allowed for attorneys' fees for the prevailing party under this fact pattern. The Court concluded that even though the Title Company was not a party to the Contract, it was entitled to an award of attorneys' fees and costs against both the Buyer and Seller because they both sought to hold the Title Company liable under the Contract for their attorneys' fees and costs. Thus, the attorneys' fees provision of the Contract applied equally to the Title Company even though it was not a signatory. The Seller appealed.

On appeal, the Court of Appeal affirmed the lower Court's Order for Attorneys' Fees and Costs in full, and awarded additional Costs on appeal. ▪

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lation of the Act did not prohibit or prevent the buyers from reselling the property, so the title was marketable, even though it was unlikely anyone would buy or lend on the lots until the violation had been cured.[3] Under the terms of the policy the insured is indemnified against a defect that exists prior to the issuance of the policy that makes the policy unmarketable but does not guarantee that the title will be marketable in the future.[4]

Similarly in *Dollinger Deanza Associates v. Chicago Title Insurance Company* (2011) 199 Cal. App. 4th 1132, Chicago Title issued the plaintiff a policy that described the land in terms of a parcel map that showed seven separate parcels. The policy did not show a notice of merger that made the seven lots one. The existence of seven separate parcels was crucial to the plaintiff because it intended to sell one of the parcels. The plaintiff alleged that the merger made the single parcel unmarketable.

The Court of Appeal agreed with the trial court and said that the notice of merger did not affect title to the land. It said that *Hocking* had defined "good title" to mean that the owner has complete legal and equitable title to the land. "Defective title" means that the party claiming ownership does not have it but is subject to the claim of ownership of a third party of all or a portion of the land. [5]No one was challenging the *Dollinger* plaintiff's ownership of the land even though its configuration as a single parcel rather than seven parcels impaired its value.

Each jurisdiction has its own definition of marketability which will control over the definition contained in a particular policy.[6] The *Hocking* decision approved of a definition set forth in the earlier case of *Staton v. Buster* (1926) 79 Cal. App. 428. A "marketable title" is "… a title which a reasonable purchaser well informed as to the facts, and their legal bearings, willing and anxious to perform his contract, would in the exercise of that prudence which business men ordinarily bring to bear on such transactions, be willing and ought to accept."[7]

As noted, marketability coverage relates to" the rights and incidents of title" and not the market value or physical condition of the land. In traditional legal terms if the insured's remedy is in personam against the seller and not in rem against the land or the title then marketability is not involved.[8]

In particular the alleged marketability defect cannot arise from someone's tortious conduct. In *SAFECO Title Insurance Company v. Moskopoulos* (1981) 116 Cal. App, 3d 368, Moskopoulos purchased a parcel of land, and SAFECO insured the transaction. After the close of escrow Klass filed an action against Moskopoulos based on his alleged actions leading up to the purchase. Klass recorded a lis pendens. Moskopoulos filed a claim against SAFECO alleging that the recorded lis pendens made the property unmarketable. The Court of Appeal ruled against Moskopoulos holding that in his action Klass was alleging that Moskopoulos had engaged in tortious conduct, not that there was any defect in the title which would result in a marketability claim.[9]

In *Mortgage Associates v. Fidelity & Deposit Company of Maryland* (2002) 105 Cal. App. 3d 28, the Court of Appeal upheld the insurer's refusal to cover the lender's loss on loans that the lender had made in excess of the value of the properties secured by the loans. The Court of Appeal said that the inflated values were a consequence of fraud attributable to the lender's employee and that after the lender foreclosed it held valid, unconditional title to all the properties. The impaired value of the land resulting from the fraud did not constitute a defect in the title to the land which would support a marketability claim.[10]

It is not always clear whether a claim relates to "the rights and incidents of title" and gives rise to a marketability claim or relates to a physical condition of the land which does not create marketability coverage. In *Mellinger v. Ticor Title Insurance Company* (2001) 93 Cal. App. 4th 691, a street named Treat Boulevard encroached on Mellinger's insured property by twenty feet. Mellinger eventually conveyed the encroachment area to the City of Concord but sued TICOR for lost profits, holding costs, and lost interest income alleging that the physical encroachment made the property unmarketable. The trial court found as a matter of law for TICOR.

The Court of Appeal found that the question of whether the encroachment was a title defect was one of fact for decision by the jury. Although the City of Concord had no title to the encroachment parcel prior to the conveyance, the question of whether a reasonable purchaser would buy the property knowing that the City of Concord and the public might assert a continuing right to use the Treat Boulevard encroachment had not been answered and was one that should have been submitted to a jury. The Court of Appeal said that the encroachment represented both a physical condition and a possible interest in the plaintiff's property.[11]

3 *Nishiyama v. SAFECO Title Insurance Company* (1978) 85 Cal. App. 3d Supp 1,7

4 Palomar, *Title Insurance Law* § 5.7 92014-2015 ed.), Pg. 1.

5 *Dollinger Deanza Associates v. Chicago Title Insurance Company* (2011) 199 Cal. App. 4th 1132,1148

6 Palomar, *Title Insurance Law* § 5.7 92014-2015 ed.), Pg. 2

7 *Staton v. Buster* (1926) 79 Cal. App. 428,432

8 Palomar, *Title Insurance Law* § 5.7 92014-2015 ed.), Pg. 3

9 *SAFECO Title Insurance Company v. Moskopoulos* (1981) 116 Cal. App, 3d 658,666

10 *Mortgage Associates v. Fidelity & Deposit Company of Maryland* (2002) 105 Cal. App. 3d 28,37

11 *Mellinger v. Ticor Title Insurance Company* (2001) 93 Cal. App. 4th 691,697

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Mellinger is a difficult case. The California Supreme Court had addressed the question of whether an encroachment rendered a title unmarketable in *Mertens v. Berendsen* (1931) 213 Cal. 111. The purchaser/plaintiff sought to rescind a contract to purchase a building in the Financial District of San Francisco because some marble veneer at the base of the building and some concrete behind it encroached on California Street. The trial record contained uncontradicted evidence that the encroachment could be removed at a cost of $ 200.

At the time the issue was one of first impression in California. The Supreme Court considered the matter as if the City were making a demand for the removal of the encroachment. The Court concluded that the encroachment was so minor that it would give no right to the City to file an action to have it removed. The owner could at most be required to pay nominal damages. There was no reasonable probability of such an action which would be required to make the title unmarketable.

The *Mertens* court said that the marketability question was one of law while the *Mellinger* court said it was one of fact. The distinction in the two decisions seems to be the difference between a negligible encroachment (*Mertens*) and a substantial encroachment (*Mellinger*).

Witkins Summary of California Law has a useful summary of the most frequently encountered situations:

1. Title Good But Land Unsalable[12]

This was the situation noted in *Hocking*, The condition of the plaintiff's land with respect to improvements to be made to it was different than what the plaintiff expected, not the condition of the title to the land. As a consequence there was no marketability claim under the policy.

2. Presence of Hazardous Substances[13]

In *Lick Mill Creek Apartments v. Chicago Title Insurance Company* (1991) 231 C.A. 3d 1654, the plaintiff sought to recover the costs of removing hazardous substances from its property under its title insurance policy. The court held that the plaintiff was not entitled to recover. The presence of the hazardous substances did not affect the marketability of the title only the property's market value. The court restated the Hocking conclusion that the marketability of the title and the market value of the land are separate and distinct concepts. The presence of hazardous materials related to the physical condition of the land, not the title.

12 *Hocking v. Title Insurance and Trust, supra* (1951) 37 Cal. 2d 644

13 *In Lick Mill Creek Apartments v. Chicago Title Insurance Company* (1991) 231 C.A. 3d 1654

3. Title is Good but Value of Land is Impaired[14]

Stewart Title Guaranty issued a title insurance policy that did not show a recorded notice of substandard building as an encumbrance. The purchaser sued Stewart, *Elysian Investment Group LLC, v. Stewart Title Guaranty Company* (2002) 105 Cal. App 4th 315, for breach of contract and bad faith for failing to inform it of the notice. The court held that the notice did not constitute a defect, lien, or encumbrance on the land or create an unmarketable title. The fact that the owner was required to bring the property up to code did not cast doubt on its ownership of title so the marketability of the title was not implicated.

If the insured does have a valid marketability claim, the courts will measure the damage as the difference in value of the property with and without the defect, *Nebo v. Transamerica Title Insurance Co.* (1971) 21 Cal. App. 3d 222.[15] The plaintiff recovered costs it had incurred during the three plus years it took the title insurer to cure the marketability defect. In *Na-*

14 *Elysian Investment Group LLC, v. Stewart Title Guaranty Company* (2002) 105 Cal. App 4th 315,324

15 *Nebo v. Transamerica Title Insurance Co.* (1971) 21 Cal. App. 3d 222,228

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Editors' Corner

The Hot Sheet invites letters to the editors. Your letters can be about anything of interest concerning avoiding claims or related subjects. If you have an idea for an article, send it to us. We also invite you to submit articles for publication in future editions of the Hot Sheet. If you are hesitant to submit a complete article, send us a rough outline of your idea. The editors will write the article and you will be given credit for the idea.

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tive Sun Investment Group, v. TICOR Title Insurance Company (1987) 189 Cal. App. 3d 1265 TICOR[16] accepted and litigated a defense of Native Sun's title against claims of the state and settled in the amount the settlement diminished the value of Native's Sun's properties.

Native Sun sued TICOR for the interest payments, property taxes, and attorney's fees it incurred between the time it acquired the property and the time the claims of the state were resolved. The court denied recovery stating that the carrying costs were not created by any title defect since the trial court found that the state's sovereign claims were without merit.

In sum, in evaluating a marketability claim on a title insurance policy, one starts with the analysis of a basic issue. Does the claim relate to the impairment of the value of the property related to a physical condition of the property (generally not covered) or a defect in the title which a the reasonable purchaser well informed as to the facts exercising business prudence noted in the *Stanton* case would refuse to accept (quite possibly covered)? And he must keep in mind that marketability is normally a question of law, but that the *Mellinger* case is an outlier and that there is precedent for finding a marketability claim to be a question of fact which must be submitted to a jury. ▪

16 *Native Sun Investment Group, v. TICOR Title Insurance Company* (1987) 189 Cal. App. 3d 1265,1275

Fraud and Forgery Checklist

by Margery Lee,
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Fraud and forgery continue to be among the top sources for claims. Some companies have created check lists for their branches and agents to consider to help identify fraud and forgery prior to consummation of the transaction. Below is a sample checklist created by North American Title Insurance Co. (NATIC).

1. Uninsured deeds, especially those recorded within the last 12 months
2. Releases, satisfactions or assignments of mortgages or deeds of trust, recorded within the last 12 months with no related sale or refinance
3. Unimproved or unoccupied property
4. Visibly altered documents
5. Last-minute change of ownership or lien additions or changes
6. Last-minute or unexplained powers of attorney or other last-minute or unexplained authority documents
7. Improper identification documents for transaction principals
8. All or virtually all sale proceeds or loan proceeds to be paid to borrower, with little or no money allocated to pay off a pre-existing loan
9. Sale with money back to buyers
10. Buyer walk-away transactions
11. "Flipping" real property
12. Requests for disbursement of seller proceeds to third parties
13. Funds passing outside of closing
14. Fraudulent or altered wire transfers and instructions
15. Unknown or unusual notaries; documents executed outside presence of notary
16. Quitclaim deeds of uncertain validity or with minimum transfer taxes recorded within the last 12 months
17. Intra-family or intra-company transactions
18. Payoffs to unknown or undocumented loan servicing agents
19. New customers or new business sources without reasonable explanation as to why agent suddenly got their business
20. Unexplained or unreasonable urgency or closing deadlines

Obviously, none of the items in the list are absolute indicators that fraud or forgery is taking place. In addition, a red flag does not necessarily mean that the transaction is fraudulent, but it does mean that a title professional should take extra steps to make sure it is legitimate. Title professionals that encounter any of these red flags should discuss the issue with their title officer, manager, supervisor or underwriter. ▪

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