Title Insurance Underwriting Review

The ALTA Commercial Endorsements

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THE ALTA COMMERCIAL ENDORSEMENTS

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THE ALTA COMMERCIAL ENDORSEMENTS

1. An Overview of the ALTA endorsements

The early American Land Title Association (ALTA) endorsements were primarily designed for residential risks. The evolving secondary market for residential mortgages in the 1970s pushed the development of those endorsements to address risks that troubled investors. Although we view the ALTA 3 and 3.1 zoning endorsements as commercial endorsements, all of the other endorsements from the ALTA 1 Street Assessment Endorsement to the ALTA 8.1 Environmental Protection Lien Endorsement were designed to protect residential mortgages.

Of course, simplicity is crucial to the volume residential mortgage market, and endorsements are a bulky fix for inadequate title insurance coverage. The recent enlargement of policy coverage, as exemplified by the ALTA Expanded Coverage Residential Loan Policy, is a more efficient solution for the residential market. Consequently, we are witnessing a shift from the emphasis on residential issues for ALTA endorsements to an emphasis on commercial issues.

The endorsements beginning with the ALTA 9 Restrictions, Encroachments, Minerals Endorsement to the ALTA 11 Mortgage Modification Endorsement made a good transition between residential and commercial, because they can be used comfortably in either market. The ALTA then began developing a series of commercial endorsements designed to meet the needs of the commercial securitization markets, beginning with the ALTA 12 Aggregation Endorsement.

With the turn of the twenty first century, this process kicked into gear as the ALTA has adopted twenty six new endorsements before turning to the development of the new basic loan policies. They were designated the ALTA 13 to ALTA 39, with many being a series of two or more endorsements addressing variations on an issue. There are more series in the pipeline.

After the 2006 policies were drafted, a new series, designated the "-06" endorsements, from the ALTA 1-06 to the ALTA 30-06 have been adapted to the new policies. The changes are modest. The new endorsements incorporate the defined terms used in the new policies, and any references to policy provisions will be changed, or eliminated (*e.g.,* the ALTA 13 leasehold endorsement drops Section 2 of the old endorsement that deletes the co-insurance provision because the 2006 Owners policy has no co-insurance provision).

The new endorsements are designated with a "-06" to avoid confusion with the endorsements for the older ALTA policies. Thus, an ALTA 14.2 endorsement is designed for a 1992 or earlier ALTA policy; and an ALTA 14.2-06 is the equivalent adapted for the 2006 ALTA policies. Like the policies, the ALTA endorsements are copyrighted and restricted for use by ALTA members or licensees.

When reviewing endorsements, pay attention to the revision date, too. Many of the ALTA forms have been modified in response to changing needs of insurance customers, or interpretations in court decisions like *Alliance Mortgage*[1] and *Nationwide*[2].

The *Alliance Mortgage* decision influenced the wording on almost every ALTA and California Land Title Association (CLTA) endorsement so it may help to understand it before we begin the analysis of the individual endorsements. A predecessor of Alliance Mortgage Company was induced by an elaborate fraud scheme to make loans on some properties in San Francisco. As a part of the deception, Ticor Title was induced to represent in an endorsement that three properties on Haight Street in San Francisco were four unit dwellings when they were merely one unit dwellings. Ticor was relying on an affidavit from the swindlers, and its endorsement represented:

> The Company assures the insured that at the date of this policy there is located on said land 4-unit Residence known as 447 Haight Street, # 1, 2, 3, 4, San Francisco, California 94117. The Company hereby insures the insured against loss which said Insured shall sustain in the event that the assurance herein shall prove to be incorrect."

Alliance alleged negligent misrepresentation by Ticor. Ticor defended with the argument that title insurance policies are not representations of the condition of the property, so it cannot be liable for misrepresentation, citing *Lawrence v. Chicago Title Ins. Co.,* 192 Cal.App.3d 70, 237 Cal. Rptr. 264 (1987). The court in *Lawrence* based its holding on the indemnity nature of title insurance, but the *Alliance Mortgage* court decided that the wording of the endorsement amounted to a guaranty instead of the "promise to indemnify, as in the conventional title policy described in Lawrence." 32 Cal. Rptr. 2nd at 605. It held Ticor liable for misrepresentation. Two months later, the court softened this holding to allowing Alliance Mortgage to proceed with its complaint in a rehearing, but the analysis in the August decision had already alarmed title insurers.

Now the convention is to use "The Company insures against loss or damage sustained by the Insured by reason of . . ." or very close variations of this language when adding to the coverage stated in the Covered Risks of the policies. You will find it in most current ALTA and CLTA endorsements. Prudent endorsement draftsmen now avoid variations of:

> The Company assures the Insured against loss or damage sustained by reason of any incorrectness in the assurance that, at Date of Policy[3]: . . . The Company hereby insures the insured against loss which said

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[1] *Alliance Mortgage Company v. Rothwell* 32 Cal. Rptr. 2d 592, 27 Cal. App. 4th 218 (Cal. App. 1st Dist. 1994) modified on reh'g, 34 Cal. Rptr.2d 700, 28 Cal. App. 4th 1764 (Cal. App. 1st Dist. 1994).

[2] *Nationwide Life Insurance Company v. Commonwealth Land Title Insurance Company* 579 F.3rd 304 (3rd Cir. 2009), *remanded to* 2011 WL 611802 (E.D. Pa 2011). The *Nationwide* decisions are discussed on page 12 in the context of their impact on the ALTA 9 series of endorsements.

[3] Section 1(b) of the Conditions of the 2006 ALTA Owners and Loan Policies define the term as:

> (b) "Date of Policy": The date designated as "Date of Policy" in Schedule A.

Insured shall sustain in the event that the assurance herein shall prove to be incorrect.

and

This policy affirmatively insures . . . .

2. Zoning

ALTA 3-06 Zoning - Vacant Land,
ALTA 3.1-06 Zoning - Completed Structure and
ALTA 3.2-06 Zoning - Land Under Development

The Zoning Endorsements were an anomaly when they appeared in 1973 as a pair of commercial endorsements in a population of residential endorsements. They are not new, but deserve recognition as commercial endorsements.

a. ALTA 3 Zoning – Vacant Land-06 Endorsement

The ALTA 3-06 is designed for insuring vacant land. It insures against loss if the zoning classification at the Date of Policy is not as shown on the endorsement and if the list of uses given in the endorsement are not allowed. However, it does not insure that the current use complies with the zoning because there are no improvements or structures to measure. As a result, it has not been very popular.

b. ALTA 3.1-06 Zoning – Completed Structure Endorsement

The ALTA 3.1 gives the same basic insurance that is found in the ALTA 3, but includes insurance against loss if the structures and improvements do not comply with the zoning with respect to

(i) Area, width or depth of the land as a building site for the structure;

(ii) Floor space area of the structure;

(iii) Setback of the structure from the property lines of the land; or

(iv) Height of the structure; or

(v) Number of parking spaces.

In 1998 the endorsements were amended as a result of *Alliance Mortgage, supra*. The old endorsements began:

1. The Company insures the Insured against loss or damage sustained by reason of any incorrectness in the assurance that, at Date of Policy:

   (a) According to applicable zoning ordinances and amendments thereto, the land is classified Zone ________________.

   (b) The following use or uses are allowed under that classification subject to compliance with any conditions, restrictions, or requirements contained in the zoning ordinances and amendments thereto, including but not limited to the securing of necessary consents or authorizations as a prerequisite to the use or uses: _________________________.

An indemnity policy must insure against loss or damage if a specified event or fact is not as indicated in the policy. The turn of the twenty-first century witnessed a scramble by the ALTA and California Land Title Association CLTA to revise all of their endorsements to fit the new model. The result made the ALTA 3 and 3.1, more than any other form, negative and rather awkward. They now begin:

> The Company insures the insured against loss or damage sustained in the event that, at Date of Policy:
>
> 1. According to applicable zoning ordinances and amendments thereto, the land is not classified Zone ________________________.
> 2. The following use or uses are not allowed under that classification: ___________________.

With the appearance of the new 2006 policy forms, we also saw two new ALTA zoning endorsements, the ALTA 3-06 and ALTA 3.1-06. In addition, the new policies are the first ALTA policies to include express coverage against loss if notice of violation or enforcement of a zoning ordinance is filed in the Public Records[4] in Covered Risk 5. This coverage may have been implied in the 1970, rev. 1984 and later ALTA policies, but it is now express in the 2006 policies. It is not the equivalent of an ALTA 3 or 3.1 coverage, so you should not change your requirements for zoning endorsements just because your project is insured with a new policy.

c. ALTA 3.2-06 Zoning – Land Under Development

The ALTA 3.2-06 gives the same basic insurance that is found in the ALTA 3.1-06, but it applies to land that will be developed with new improvements. A customer who buys vacant land with a plan for developing it was limited to the ALTA 3-06, unless it could persuade the title insurer to modify an ALTA 3.1-06 to insure the proposed development. Even those buying improved land with plans for significant additions were limited to zoning coverage as of the Date of Policy with an ALTA 3.1-06. The Forms Committee recognized a need for Land Under Development endorsements for zoning and other issues. The ALTA 3.2-06 is an ALTA 3.1-06 modified to insure the zoning for a project if it is built according to the plans identified in the endorsement. It adds flexibility to the products offered in title insurance.

The endorsement adds two definitions. First, it defines "Improvement" as a "building, structure, road, walkway, driveway, curb, subsurface utility or water well existing at Date of Policy or to be built or constructed according to the Plans." It encompasses Improvements located on the Land[5] at the Date of Policy, and any Improvement to be built according to the Plans. It does not include landscaping.

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[4] Sections 1(i) and 1(k) of the Conditions of the 2006 ALTA Owners and Loan Policies, respectively, define the term as:

> "Public Records": Records established under state statutes at Date of Policy for the purpose of imparting constructive notice of matters relating to real property to purchasers for value and without Knowledge. With respect to Covered Risk 5(d), "Public Records" shall also include environmental protection liens filed in the records of the clerk of the United States District Court for the district where the Land is located.

[5] Sections 1(g) and 1(i) of the Conditions of the 2006 ALTA Owners and Loan Policies, respectively, define the term as:

The endorsement defines the "Plans" as those site and elevation plans made by [*name of architect or engineer*] dated ____, last revised ________, designated as [*name of project*] consisting of ___sheets. The definition of Plans is only necessary to define the scope of the definition of "Improvement." Now the insurance from the ALTA 3.1-06 that zoning parameters are not violated will apply to Improvements built in accordance to the plans as well as those existing on the property at Date of Policy.

3. Variable Rate Mortgage

ALTA 6-06 (Variable Rate Mortgage) and
ALTA 6.2-06 (Variable Rate Mortgage – Negative Amortization)

a. ALTA 6-06 Variable Rate Mortgage Endorsement

The Variable Rate Mortgage Endorsements were crafted for residential transactions at the request of Fannie Mae and Freddie Mac, but any mortgage loan, residential or commercial, may have a variable interest rate feature. There is nothing in the ALTA 6 or 6.2 (the ALTA 6.1 was a form of limited ALTA 6 coverage that has become obsolete since the 1970s) that limits its use to residential mortgages, only. So, it is not unusual to encounter an endorsement request on a commercial loan that specifies one of these ALTA 6 endorsements.

Commercial lenders especially had one objection to the ALTA 6 and 6.2. The original endorsements use the term "changes in the rate of interest" but the definition of "changes in the rate of interest" was limited to ". . . only those changes in the rate of interest calculated pursuant to the formula provided in the Insured Mortgage at Date of Policy." The parties to a mortgage, and especially commercial mortgages, do not want to reveal the negotiated interest rate in a document that will be recorded in the Public Records. Under the original form, a lender faced a Hobson's choice of either disclosing the confidential interest rate in the mortgage to get the coverage, or not disclosing the interest rate in the mortgage and risking losing its coverage. It was incongruous that the ALTA endorsement required a disclosure in the mortgage that nobody in the marketplace was willing to make. Title insurance protects the lien of the Insured Mortgage[6], not the repayment of the indebtedness, so the ALTA composed the definition to refer to the mortgage.

Because the original approach was too rigid, the endorsements were amended by the ALTA on October 16, 2008 to correct that problem. The definition was changed to read:

> "Changes in the rate of interest", as used in this endorsement, shall mean only those changes in the rate of interest calculated pursuant to the formula provided in the loan documents

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(i) "Land": The land described in Schedule A, and affixed improvements that by law constitute real property. The term "Land" does not include any property beyond the lines of the area described in Schedule A, nor any right, title, interest, estate, or easement in abutting streets, roads, avenues, alleys, lanes, ways, or waterways, but this does not modify or limit the extent that a right of access to and from the Land is insured by this policy.

[6] Section 1(g) of the Conditions of the 2006 ALTA Loan Policies define the term as:

(g) "Insured Mortgage": The Mortgage described in paragraph 4 of Schedule A.

secured by the Insured Mortgage at Date of Policy.

That's better. Now, the Insured decides on what disclosures to make in the recorded loan documents without jeopardizing its title insurance coverage.

b. ALTA 6.2-06 Variable Rate Mortgage Endorsement – Negative Amortization

The ALTA 6.2 adds "interest on interest" and "the addition of unpaid interest to the principal balance of the loan' to the coverage for "changes in the rate of interest" found in the ALTA 6-06. Because the ALTA 6.2-06 expands on the coverage found in the ALTA 6-06, it is never necessary to issue both endorsements in the same policy, but title insurers will probably balk at issuing an ALTA 6.2-06 on a mortgage securing a loan that does not have a negative amortization feature.

4. Environmental Protection Lien

ALTA 8.2-06 (Commercial Environmental Protection Lien)

Fannie Mae required the ALTA 8.1-06 Environmental Protection Lien Endorsement as a condition to its acceptance of the 1987 ALTA Loan policies because environmental liens were the big issue in the mid 1980s. Several states had just enacted environmental cleanup statutes that not only gave the state a lien against land for the cost of cleanup, but also provided for super-priority of its clean-up lien over any other lien on the land as well.

a. ALTA 8.1-06 Zoning – Environmental Protection Lien Endorsement

Paragraph (a) of the endorsement indemnified the Insured against loss of priority to environmental protection liens filed on the Date of Policy in the Public records, but paragraph (b) insured against loss of priority to any state environmental liens even if the lien is filed after the Date of Policy, if the statute creating the super-lien was not excepted in the endorsement. The endorsement was expressly limited to residential mortgages because virtually all super-priority lien statutes included a residential exemption. If Fannie Mae discovered a super priority environmental lien statute without a residential exemption, it would threaten to suspend purchases of mortgages in that state until the law was revised because it expected the title insurers to except to them following paragraph (b).

The ALTA 8.1 is unsuitable for commercial transactions because the exemptions in the super-priority lien statutes apply only to residential mortgages. The risk of loss to an environmental super-lien on a commercial mortgage is unmanageable. A thorough phase I environmental survey report can be expected to list pages of chemical compounds identified on the property, and title insurers do not have the skill to determine if a state might require a cleanup of any of them.

b. ALTA 8.2-06 Zoning – Commercial Environmental Protection Lien Endorsement

To address the demand for a commercial variation of the environmental lien protection endorsement, the ALTA adopted the ALTA 8.2 Commercial Environmental Protection Lien Endorsement on October 16, 2008. It broadens the paragraph (a) coverage by eliminating the limitation of the coverage to "lack of priority of the lien of the insured mortgage." Instead the new endorsement "insures against loss or damage sustained by the Insured by reason of an environmental protection lien that, at Date of Policy, is recorded in the Public Records. . ." Consequently, it is suitable for owner's coverages as well as loan coverages.

Of course, neither of these environmental protection lien endorsements insures that the land is clean, or even suggests that it does. Title insurance statutes impose a single line restriction on title insurers that is prohibits title insurers from insuring any other kind of risk. Environmental cleanup insurance is a property/casualty line of insurance, so title insurers may not accept that risk. The single line restrictions are imposed on title insurance because an insurance line without deductibles, annual renewal premiums, and low statutory premium reserves cannot bear these risks.[7]

5. Covenants

Restrictions, Encroachments, Minerals

ALTA 9-06 (Loan) and
ALTA 9.7-06 (Land Under Development- Loan;

Covenants Conditions and Restrictions

ALTA 9.1-06 (Owners-Unimproved Land),
ALTA 9.2-06 (Owners-Improved Land),
ALTA 9.3-06 (Loan),
ALTA 9.8-06 (Owners-Land Under Development)

Private Rights

ALTA 9.6-06 (Private Rights),

The ALTA adopted the ALTA 9 Restrictions, Encroachments, Minerals (REM) Endorsement for Loan Policies in October 1988. Ten years later, the ALTA adopted two

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7 *Chicago Title Insurance Co. v. Kumar*, 24 Mass. App. Ct. 53, 506 N.E.2d 154 (1987); *South Shore Bank v. Stewart Title Guaranty Co.*, 688 F. Supp. 803 (D. Mass. 1988); *Lick Mill Creek Apartments v. Chicago Title Insurance Company*, 231 Cal. App. 3d 1654, 283 Cal. Rptr 231 (1991), *appeal denied,* Aug. 29, 1991; and *Fleet Finance, Inc. of Georgia v Lawyers Title Insurance Corporation* No 1:88-cv-1672-HTW (N.D. Ga. Dec. 29, 1989). Related decisions in *Manley v Cost Control Marketing and Management, Inc*, 583 A.2d 442 (Pa. Super. 1990), *Frimberger v. Anzellotti*, 594 A.2d 1029 (Conn. App. 1991) and *Bear Fritz Land Co. v. Kachmak Bay Title Agency, Inc*., 920 P.2d 759 (1996) held that latent physical environmental defects were not "encumbrances" on title. Where a party attempts to rescind a purchase of contaminated real estate, the Sixth Circuit held that "_environmental contaminants may diminish the value of the realty, but they do not constitute an encumbrance because they do not affect title." *Donehey v. Bogle*, 987 F.2d 1250 (6th Cir. 1993), reh'g denied, 1993 USApp LEXIS 14303 (1993).

versions for owner's policies, the ALTA 9.1 for unimproved land, and the ALTA 9.2 for improved land. The ALTA 9 is a derivation of a California endorsement, the CLTA 100. On April 2, 2012, the ALTA adopted substantially revised versions of these endorsements in response to a February 17, 2011 decision by the U.S. District Court for the Eastern District of Pennsylvania in *Nationwide Life Insurance v. Commonwealth Land*[8], and demand for the endorsement is situations where combining three coverages might not be appropriate.

These endorsements have been referred to as the "comprehensive" endorsements, but the name is a misnomer and I discourage it. The endorsements deal only with discrete issues as their official names suggest.

a. The Endorsements before 2012

The most important issue is coverage over risks posed by covenants, conditions or restrictions. In the versions of the ALTA 9 from its inception to the 6-17-06 revision, it is spread throughout sections 1.a, 1.b, 2 and 5, and I have extracted those coverages in the following paragraphs:

> The Company insures the owner of the Indebtedness secured by the Insured Mortgage against loss or damage sustained by reason of:
>
> 1. The existence, at Date of Policy, of any of the following:
>   a. Covenants, conditions, or restrictions under which the lien of the Insured Mortgage can be divested, subordinated, or extinguished, or its validity, priority, or enforceability impaired.
>   b. Unless expressly excepted in Schedule B
>   (i) Present violations on the Land of any enforceable covenants, conditions, or restrictions, and any existing improvements on the land described in Schedule A that violate any building setback lines shown on a plat of subdivision recorded or filed in the Public Records.
>   (ii) Any instrument referred to in Schedule B as containing covenants, conditions, or restrictions on the Land that, in addition, (A) establishes an easement on the Land; (B) provides a lien for liquidated damages; (C) provides for a private charge or assessment; (D) provides for an option to purchase, a right of first refusal, or the prior approval of a future purchaser or occupant.. . .
>   (v) Any notices of violation of covenants, conditions, or restrictions relating to environmental protection recorded or filed in the Public Records.
> 2. Any future violation on the Land of any existing covenants, conditions, or restrictions occurring prior to the acquisition of title to the estate or interest in the Land by the Insured, provided the violation results in
>   a. the invalidity, loss of priority, or unenforceability of the lien of the Insured Mortgage; or
>   b. the loss of Title if the Insured shall acquire Title in satisfaction of the Indebtedness secured by the Insured Mortgage. . .

[8] 2011 WL 611802 slip op.

5. Any final court order or judgment denying the right to maintain any existing improvements on the Land because of any violation of covenants, conditions, or restrictions, or building setback lines shown on a plat of subdivision recorded or filed in the Public Records.

Wherever in this endorsement the words "covenants, conditions, or restrictions" appear, they shall not be deemed to refer to or include the terms, covenants, conditions, or limitations contained in an instrument creating a lease.

As used in paragraphs 1.b(i) and 5, the words "covenants, conditions, or restrictions" do not include any covenants, conditions, or restrictions (a) relating to obligations of any type to perform maintenance, repair, or remediation on the Land, or (b) pertaining to environmental protection of any kind or nature, including hazardous or toxic matters, conditions, or substances, except to the extent that a notice of a violation or alleged violation affecting the Land has been recorded or filed in the Public Records at Date of Policy and is not excepted in Schedule B.

The encroachment coverage was in sections 1.b.iii, 1.b.iv, 3.a and 4. Those coverages were:

The Company insures the owner of the Indebtedness secured by the Insured Mortgage against loss or damage sustained by reason of:

1. The existence, at Date of Policy, of any of the following: . . .
   b. Unless expressly excepted in Schedule B . . .
      (iii) Any encroachment of existing improvements located on the Land onto adjoining land, or any encroachment onto the Land of existing improvements located on adjoining land.
      (iv) Any encroachment of existing improvements located on the Land onto that portion of the Land subject to any easement excepted in Schedule B. . .
3. Damage to existing improvements, including lawns, shrubbery, or trees
   a. that are located on or encroach upon that portion of the Land subject to any easement excepted in Schedule B, which damage results from the exercise of the right to maintain the easement for the purpose for which it was granted or reserved; . . .
4. Any final court order or judgment requiring the removal from any land adjoining the Land of any encroachment excepted in Schedule B.

The mineral coverage in the ALTA 9 was contained in Section 3.b. It read:

3. Damage to existing improvements, including lawns, shrubbery, or trees . . .
   b. resulting from the future exercise of any right to use the surface of the Land for the extraction or development of minerals excepted from the description of the Land or excepted in Schedule B.

The coverage in the ALTA 9 and 9.3 (and their "-06" equivalents) for loan policies was more comprehensive than in the various endorsements for owners' policies. The loan variants insured matters affecting the lien of the Insured Mortgage. In addition, a title insurer may be willing to insure against damage to lawns, shrubbery and trees for a lender because the risk is so remote, but it would be unmanageable to protect an owner from damage to lawns, shrubbery and

trees for the exercise of a right to service or maintain an easement. Consequently, the endorsements for owners did not indemnify the Insured for damage to lawns, shrubbery or trees.

The endorsements were designed to insure against certain covenant, condition and restriction (CC&R) matters and damage to stated improvements because of surface use for mineral development or encroachments. They had accumulated some new provisions over the years since the introduction of their progenitor, the (CLTA) 100 endorsement, but that process scrambled the organization of provisions, so the forms addressed some CC&R coverages, then encroachments and minerals and then returned to CC&Rs.

b. *Nationwide v. Commonwealth*

Section 1(b)(ii) of the ALTA 9 insured against loss by reason of the existence at Date of Policy of certain matters, Unless expressly excepted in Schedule B, including “Present violations on the Land of any enforceable covenants, conditions, or restrictions….[and] Any instrument referred to in Schedule B as containing covenants, conditions, or restrictions on the Land that, in addition, (i) establishes an easement on the Land, (ii) provides for an option to purchase, a right of first refusal, or the prior approval of a future purchaser or occupant, or (iii) provides a right of reentry, possibility of reverter, or right of forfeiture because of violations on the Land of any enforceable covenants, conditions, or restrictions.”

In 2004, Nationwide Life Insurance Company filed a suit against Commonwealth Land Title Insurance Company after Nationwide had lost a sale of a foreclosed Pharmor retail drug store building in a shopping center because the shopping center Declaration of Restrictions prevented Nationwide’s buyer, Lincoln Technical Institute, from operating a technical training school in the former Pharmor building. Lincoln Technical Institute rescinded the contract to buy the building, so Nationwide asserted that the restrictions contained a right of prior approval and Section 1(b)(ii)of the ALTA 9 indemnified it against the loss. The paragraph with the alleged right of prior approval said:

> Buyer shall have the right to use the Property and/or the building for any single retail use which is (1) permitted under all applicable laws, ordinances, orders, rules, regulations and requirements of all governmental authorities having jurisdiction over the Shopping Center Project, (2) consistent with and permitted under the Master Declaration, and (3) compatible with an enclosed super-regional discount specialty retail shopping center (or such other type of shopping center as may be operated by Seller within the Shopping Center Project in the future); provided, however, that in no event shall Buyer use the Property and/or the building for any of the purposes listed on Exhibit 3 [listing the types of stores already in the Mall]; and provided further, however, that Buyer shall not change the use of the Property from a variety or general merchandise store (as described above) without prior written consent of Seller (which shall not be unreasonably withheld or delayed if the proposed use otherwise satisfies the foregoing requirements of this sentence.) In no event shall the Property be

> used or occupied for any purpose or in any manner other than as set forth in this [paragraph]. With respect to the foregoing restrictions on the use of the Property, Buyer hereby acknowledges and agrees that the Property is part of the larger Shopping Center Project, and that Seller has a substantial interest in the ownership and operation of the Shopping Center Project. Accordingly, Seller desires to insure that the Property being conveyed to Buyer will be used in a manner consistent with the plans and designs of Seller (for both the appearance and the operation of the Shopping Center Project) and not in a manner that would injure or adversely affect the remaining portions of the Shopping Center Project and/or the operation thereof. Buyer hereby further acknowledges the legitimacy of these objections, and acknowledges and agrees that its acceptance of the use restrictions set forth in this Sub-paragraph 2(A) is a material inducement to Seller to convey the Property to Buyer, by virtue of its need to protect the legitimate objectives more particularly described above. Emphasis added.

It's a bit of a stretch to identify this provision as a "a right of first refusal, or the prior approval of a future purchaser or occupant." It is a use restriction, and the use proposed by Lincoln Technical Institute was not included in the Declaration of Restrictions. A right of prior approval of a future purchaser or occupant is a restriction against, in a case like this, another anchor store that would put the shopping center into violation of its lease covenants with an existing anchor. The most memorable example of an exercise of a right of prior approval of a future purchaser or occupant occurred in 1980 when Former president Nixon was refused the right to buy a cooperative apartment in New York City by a vote of the existing owners. It can occur in a shopping center context when a major tenant requires a right of prior approval to exclude major competitors from the center.

The district court rejected Nationwide's arguments because there was an exception for the Declaration of Restrictions. *Nationwide Life Ins. Co. v. Commonwealth Land Title Ins. Co.,* 2005 WL 2716492, (E.D. Pa. Oct. 19, 2005). The district court decided for Commonwealth because the policy excepted to the declaration in Schedule B. However, Section 1(b)(ii) only applied to instruments "referred to in Schedule B," so a simple exception should not be enough to excuse the title insurer from liability. This opinion by the district court was a little too superficial.

Nationwide appealed to the Third Circuit. On August 31, 2008, the Third Circuit, at 579 F.3d 304, decided that the exception would not be adequate if there was a right of prior approval in the Declaration of Restrictions and remanded the case to the district court.

The ALTA Forms Committee, viewing the two decisions, decided that if there was a right of prior approval (which was not clear from the first two opinions), that the "Unless expressly excepted in Schedule B" language of Section 1(b) of the ALTA 9 was not sufficiently clear that the endorsement would insure against loss from a matter like a CC&R with a right of prior approval unless Schedule B of the policy took exception to the document including the CC&Rs

and also took exception to right of prior approval. It was a good opportunity to organize the endorsement as well. On February 3, 2011, the Forms Committee adopted revised forms.

On February 17, 2011, shortly after the revised forms were adopted, the U.S. District Court for Eastern District of Pennsylvania rendered its memorandum opinion on the remand of the case from the Third Circuit. It held that an ALTA 9 would virtually insure over an exception to a document containing covenants, conditions and restrictions by changing Section 1(b)(2) into a set of coverage triggers instead of coverage:

> In short, the Court finds that the ALTA 9 Endorsement provides insurance coverage for any loss arising from any instrument referenced in Schedule B that contains both covenants, conditions, or restrictions, as well as, among other items, an option to purchase, a right of first refusal, or a prior approval of a future purchaser or occupant. The Endorsement does not restrict its coverage to specific provisions within such instruments. *Nationwide Life Insurance Company v. Commonwealth Land title Insurance Company*, 2011 WL 611802 slip op. at 27 (E. D. PA 2011).

In this decision, the district court made up for its superficial analysis in that first opinion with a second opinion that swings the pendulum too far in other direction, almost to the extent of malicious compliance. Policyholders expect title insurers who issue this endorsement to call out any of those private rights listed in Section 1(b)(ii) of the ALTA 9 to assist in their review of the title. If the title company must except to everything in the instrument to avoid liability, those private rights will become lost in the jumble of exceptions added to Schedule B. Most customers work hard to get title insurers to minimize the exceptions in Schedule B, so this interpretation doesn't work for either title insurers or their customers. If the policy can be interpreted as the district court read it, the ALTA had to rewrite the endorsement to return to the original object of calling out only those personal rights that lenders have asked title insurers to show.

In addition, Nationwide asserted that the ALTA 9 coverage is independent of the policy despite the incorporation paragraph that ends each ALTA endorsement. Realizing that the forms would be revised within the year, most title companies de-emphasized the 2/03/2011 revisions so title insurance customers would not become confused by all of the revision activity. The new forms became effective on April 2, 2012 after passing through the comment period.

c. <u>ALTA 9-06 Restrictions Encroachments Minerals Endorsement – Loan Policy</u>

The ALTA 9, insuring lenders, is the form derived from the CLTA 100 in 1988. It retains most of the features of the 2006 version, except old Section 1(b)(ii), that was litigated in the Nationwide case is now moved from this endorsement to the ALTA 9.6-06, so The ALTA 9 retains its original name. The ALTA added an incorporation preamble, similar to the preamble for the Covered Risks in the policy to emphasize that the coverages are part of the policy coverages and not stand alone insurance.

The revised form added two definitions. The first defines "Covenant" as "a covenant, condition, limitation or restriction in a document or instrument in effect at Date of Policy." The

term is in the singular instead of the old "covenants, conditions, and restrictions" to avoid any interpretation that a failure to except to any one triggers liability for all. The ALTA 9-06 also defined "Improvement" as "an improvement, including any lawn, shrubbery, or trees, affixed to either the Land or adjoining land at Date of Policy that by law constitutes real property." This definition does not appear in the other revised ALTA 9 endorsements because the encroachments and minerals coverages were dropped from them.

Section 3 of the new ALTA 9-06 rephrased the Covenant coverage to avoid the ambiguity caused by the "Unless expressly excepted in Schedule B" language in the earlier versions applied the coverage to single risks. It reads:

> 3. The Company insures against loss or damage sustained by the Insured by reason of:
>
>   a. A violation of a Covenant that:
>
>   i. divests, subordinates, or extinguishes the lien of the Insured Mortgage,
>
>   ii. results in the invalidity, unenforceability or lack of priority of the lien of the Insured Mortgage, or
>
>   iii. causes a loss of the Insured's Title acquired in satisfaction or partial satisfaction of the Indebtedness;
>
>   a. A violation on the Land at Date of Policy of an enforceable Covenant, <u>unless an exception in Schedule B of the policy identifies the violation</u>;
>
>   b. Enforced removal of an Improvement located on the Land as a result of a violation, at Date of Policy, of a building setback line shown on a plat of subdivision recorded or filed in the Public Records, <u>unless an exception in Schedule B of the policy identifies the violation</u>; or
>
>   c. A notice of a violation, recorded in the Public Records at Date of Policy, of an enforceable Covenant relating to environmental protection describing any part of the Land and referring to that Covenant, but only to the extent of the violation of the Covenant referred to in that notice, <u>unless an exception in Schedule B of the policy identifies the notice of the violation.</u> (emphasis added).

Since the endorsements were adopted, many have asked if that provision at the end of each coverage requiring an exception in Schedule B requires separate exceptions for the document and the violation or notice of the violation, or will one exception that mentions both do? I think either is acceptable so long as the exception clearly indicates that there is a violation. If there is a notice of a violation in the Public Records, it might be better to have separate exceptions for the document and the notice, but one should follow the other to assist the Insured in its review of the policy.

Section 5 of the ALTA 9-06 excepts Covenants in a lease, Covenants creating obligations to maintain, repair or remediate and Covenants "relating to environmental protection of any kind or nature, including hazardous or toxic matters, conditions, or substances." It also excepts "contamination, explosion, fire, fracturing, vibration, earthquake or subsidence; or contamination, explosion, fire, fracturing, vibration, earthquake or subsidence. This Section 5 also appears in the ALTA 9.7-06.

d. ALTA 9.1-06 Covenants Conditions and Restrictions Endorsement - Unimproved Land – Owner's Policy

This endorsement introduces the most striking change from the old series. The encroachment and mineral coverages have been deleted, so the endorsement covers only CC&R issues. The Forms Committee did that because there were too many cases where the old endorsements were requested in situations that the insurer was unwilling to insure all three risks. You can still get the encroachment coverages in the ALTA 28 series and minerals coverage in the new ALTA 35 series. Its CC&R coverages parallel the new style introduced in the ALTA 9-06 above, for those that apply to ownership of unimproved land.

There is no need for a definition of "Improvement" so section 2 only defines "Covenant." Section 3, containing the insurance provisions provides:

> 3. The Company insures against loss or damage sustained by the Insured by reason of:
>
>   a. A violation on the Land at Date of Policy of an enforceable Covenant, unless an exception in Schedule B of the policy identifies the violation; or
>
>   b. A notice of a violation, recorded in the Public Records at Date of Policy, of an enforceable Covenant relating to environmental protection describing any part of the Land and referring to that Covenant, but only to the extent of the violation of the Covenant referred to in that notice, unless an exception in Schedule B of the policy identifies the notice of the violation.

Section 4 of the ALTA 9.1-06 excepts Covenants in a lease, Covenants creating obligations to maintain, repair or remediate and Covenants "relating to environmental protection of any kind or nature, including hazardous or toxic matters, conditions, or substances." This Section 4 is also included in the ALTA 9.2-06, the ALTA 9.3-06, the ALTA 9.6-06 and the ALTA 9.8-06.

e. ALTA 9.2-06 Covenants Conditions and Restrictions Endorsement - Improved Land – Owner's Policy

Like the ALTA 9.1-06, this endorsement is also limited to CC&R issues and has the corresponding changes made in the two preceding endorsements for coverages that apply to ownership of improved land. It differs from the ALTA 9.1-06 by adding the definition of Improvement back into Section 2 and expanding the coverage of Section 3 as follows:

> 3. The Company insures against loss or damage sustained by the Insured by reason of:
>
>   a. A violation on the Land at Date of Policy of an enforceable Covenant, unless an exception in Schedule B of the policy identifies the violation;
>
>   b. Enforced removal of an Improvement as a result of a violation, at Date of Policy, of a building setback line shown on a plat of subdivision recorded or filed in the Public Records, unless an exception in Schedule B of the policy identifies the violation; or
>
>   c. A notice of a violation, recorded in the Public Records at Date of Policy, of an enforceable Covenant relating to environmental protection

> describing any part of the Land and referring to that Covenant, but only to the extent of the violation of the Covenant referred to in that notice, unless an exception in Schedule B of the policy identifies the notice of the violation.

f. ALTA 9.3-06 Covenants Conditions and Restrictions Endorsement - Loan Policy

This lender's endorsement is also limited to CC&R issues. It is now an ALTA 9-06 without the encroachment and minerals coverage. Of all the endorsements, you should take care now with your endorsement requests because this endorsement exceeded the ALTA 9-06 by its coverage for loss to caused by the exercise of any right to use the surface of the Land for the extraction or development of minerals to buildings located on the land either on or after the Date of Policy. Now it has no coverage for that risk at all.

g. ~~ALTA 9.4-06 and 9.5 Restrictions Encroachments Minerals Endorsement – Owner's Policy~~

These designations are intentionally omitted from the current series to avoid confusion with their predecessors. They were equivalents to the old ALTA 9.3-06 coverage for unimproved and improved land, respectively, in owner's policies and the coverage is no longer needed. The following endorsements are not revisions of the existing ALTA 9s, but entirely new endorsements adopted by the ALTA.

h. ALTA 9.6-06 Private Rights - Loan Policy

In this endorsement, a "Private Right" is defined as (i) a private charge or assessment; (ii) an option to purchase; (iii) a right of first refusal; or (iv) a right of prior approval of a future purchaser or occupant. At first blush, this appears to be the coverage litigated in the *Nationwide* case redrafted to avoid the interpretation suggested in the Third Circuit opinion and applied in the February 2011district court opinion placed in a separate endorsement. However the approach to the coverage is also changed. In the older forms of the ALTA 9s, this coverage insured against any loss caused by the failure of the title insurer to specifically call out a private right in the exceptions. As we have seen in the *Nationwide* case, a court may find a provision in a document to be a Private Right, like a right of prior approval of a future purchaser or occupant, that a title examiner might not recognize on a careful review of the document. It would be too cumbersome for a title insurer to require senior underwriting counsel review of all Title documents as a condition to issuing the ALTA 9 endorsements because they are required on most policies. And even that might not screen all of the potential risks. How many experienced lawyers would have paused over the Phar-Mor restriction to question whether a court might not view it as "a right of prior approval of a future purchaser or occupant?" So the Forms Committee limited the coverage in the ALTA 9.6-06 to say in Section 3:

> 3. The Company insures against loss or damage sustained by the Insured under this Loan Policy if enforcement of a Private Right in a Covenant affecting the Title at Date of Policy (a) results in the invalidity, unenforceability or lack of priority of the lien of the Insured Mortgage, or (b) causes a loss of the Insured's Title acquired in satisfaction or partial satisfaction of the Indebtedness.

Now the Insured must show that a Private Right made the Insured Mortgage unenforceable or invalid, or that it affected the priority of the Insured Mortgage. If the Insured has taken Title in satisfaction of the Indebtedness, the coverage will only be triggered by a loss of its Title. The endorsement does not insure against a loss of marketable title, which is the gist of the Nationwide claim.

After the ALTA 9.6-06 was issued in April 2012, some users were concerned that it lacked a means of excepting a document from its coverage if that document included a Private Right affects the validity, enforceability or priority of the lien of the Insured Mortgage. As a result, the endorsement was amended on April 2, 2013 to add new Section 4(d):

> 4. This endorsement does not insure against loss or damage (and the Company will not pay costs, attorneys' fees, or expenses) resulting from:
>
>   a. any Covenant contained in an instrument creating a lease;
>
>   b. any Covenant relating to obligations of any type to perform maintenance, repair, or remediation on the Land;[or]
>
>   c. any Covenant relating to environmental protection of any kind or nature, including hazardous or toxic matters, conditions, or substances[; or
>
>   d. <u>any Private Right in an instrument identified in Exception(s) ______ in Schedule B].</u>

i. <u>ALTA 9.7-06 Restrictions Encroachments Minerals Endorsement – Land Under Development Loan Policy</u>

This is an ALTA 9-06 with a Land Under Development provision at the beginning so the policyholder will get the coverages applied to improvements under development. Section 2 adds the following definitions in the ALTA 9.7-06:

> d. "Future Improvement" means a building, structure, road, walkway, driveway, curb, lawn, shrubbery or trees to be constructed on or affixed to the Land in the locations according to the Plans and that by law will constitute real property.
>
> e. "Improvement" means an improvement, including any lawn, shrubbery, or trees, affixed to either the Land or adjoining land at Date of Policy that by law constitutes real property.
>
> f. "Plans" means the survey, site and elevation plans or other depictions or drawings prepared by <u>*(insert name of architect or engineer)*</u> dated ____, last revised ________, designated as <u>*(insert name of project or project number)*</u> consisting of ___ sheets.

Sections 3(a) and (b) were amended to include references to "Future Improvements" as well as "Improvements"

j. <u>ALTA 9.8-06 Covenants Conditions and Restrictions Endorsement – Land Under Development Owner's Policy</u>

This is an ALTA 9.2-06 with a Land Under Development provision at the beginning so the policyholder will get the coverages applied to improvements under development. The

definitions of "Improvements" and "Future Improvements" in Section 2 of this endorsement exclude "any crops, landscaping, lawn, shrubbery, or trees."

k. ALTA 9.9-06 Private Rights - Owner's Policy

In this endorsement, Private Rights are limited to (i) an option to purchase; (ii) a right of first refusal; or (iii) a right of prior approval of a future purchaser or occupant. Unlike the ALTA 9.6, it does not include a private charge or assessment. Section 3 provides the insurance:

> 3. The Company insures against loss or damage sustained by the Insured under this Owner's Policy if enforcement of a Private Right in a Covenant affecting the Title at Date of Policy based on a transfer of Title on or before Date of Policy causes a loss of the Insured's Title.

Section 4 of the endorsement is the same as Section 4 of the ALTA 9.6-06. It contains the exceptions from the coverage.

k. ALTA 9.10-06 Covenants Conditions and Restrictions Endorsement – Current Violations - Loan Policy

The only difference between the ALTA 9-06 and the ALTA 9.10-06 is in Section 3(a). The ALTA 9 says:

> 3. The Company insures against loss or damage sustained by the Insured by reason of:
>   a. A violation of a Covenant that:
>   i. divests, subordinates, or extinguishes the lien of the Insured Mortgage,
>   ii. results in the invalidity, unenforceability or lack of priority of the lien of the Insured Mortgage, or
>   iii. causes a loss of the Insured's Title acquired in satisfaction or partial satisfaction of the Indebtedness;

Compare that to the same Section of the ALTA 9.10-06:

> 3. The Company insures against loss or damage sustained by the Insured by reason of:
>   a. A violation at Date of Policy of a Covenant that:
>   i. divests, subordinates, or extinguishes the lien of the Insured Mortgage,
>   ii. results in the invalidity, unenforceability or lack of priority of the lien of the Insured Mortgage, or
>   iii. causes a loss of the Insured's Title acquired in satisfaction or partial satisfaction of the Indebtedness;

So, for the coverages in the ALTA 9-06, a violation either existing on Date of Policy or in the future will trigger the insurance. For the ALTA 9.10-06, the violation must occur on or before the Date of Policy to trigger coverage. No other provision of the ALTA 9-06 was altered in the ALTA 9.10-06.

6. Mortgage Assignment

ALTA 10-06 (Mortgage Assignment)

ALTA 10.1 (Mortgage Assignment and Datedown)

The ALTA loan policy was designed to insure "the owner of the Indebtedness[9]," even if that owner is not the named Insured in Schedule A of the policy. Lenders have insisted on this flexibility so the title insurance policy does not become a barrier to the transferability of the note. This basic feature is built into Section 1(e)(i)(A) of the Conditions in the definition of the term Insured:[10]

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[9] Section 1(d) of the Conditions of the 2006 ALTA Loan Policies define the term as:

(d) "Indebtedness": The obligation secured by the Insured Mortgage including one evidenced by electronic means authorized by law, and if that obligation is the payment of a debt, the Indebtedness is the sum of

(i) the amount of the principal disbursed as of Date of Policy;

(ii) the amount of the principal disbursed subsequent to Date of Policy;

(iii) the construction loan advances made subsequent to Date of Policy for the purpose of financing in whole or in part the construction of an improvement to the Land or related to the Land that the Insured was and continued to be obligated to advance at Date of Policy and at the date of the advance;

(iv) interest on the loan;

(v) the prepayment premiums, exit fees, and other similar fees or penalties allowed by law;

(vi) the expenses of foreclosure and any other costs of enforcement;

(vii) the amounts advanced to assure compliance with laws or to protect the lien or the priority of the lien of the Insured Mortgage before the acquisition of the estate or interest in the Title;

(viii) the amounts to pay taxes and insurance; and

(ix) the reasonable amounts expended to prevent deterioration of improvements;

but the Indebtedness is reduced by the total of all payments and by any amount forgiven by an Insured.

[10] Section 1(e) of the Conditions of the 2006 ALTA Loan Policies define the term as:

(e) Insured": The Insured named in Schedule A.

(i) The term "Insured" also includes

(A the owner of the Indebtedness and each successor in ownership of the Indebtedness, whether the owner or successor owns the Indebtedness for its own account or as a trustee or other fiduciary, except a successor who is an obligor under the provisions of Section 12(c) of these Conditions;

(B) the person or Entity who has "control" of the "transferable record," if the Indebtedness is evidenced by a "transferable record," as these terms are defined by applicable electronic transactions law;

(C) successors to an Insured by dissolution, merger, consolidation, distribution, or reorganization;

(D) successors to an Insured by its conversion to another kind of Entity;

(E) a grantee of an Insured under a deed delivered without payment of actual valuable consideration conveying the Title

However, if a lender relies only on the definition of the term "Insured," the assignment of the mortgage is not a part of the insured transaction. In most cases, that isn't a troubling issue. The title insurer will recognize the holder of the Indebtedness as the Insured in a claim, but if the claim involves a challenge to the validity or enforceability of the assignment itself, the title insurer will have no liability under the policy to defend or indemnify under the policy. If there is nothing irregular in the chain of endorsements to the note, or its ownership shown in a "transferable record" at MERS, the definition of Insured should suffice to protect an assignee.

But what if the assignee receives the note from the FDIC as receiver, and there is no endorsement to the FDIC, so there is some doubt that FDIC is the appropriate assignor. The policy has another avenue for this uncomfortable assignee if the assignment can be added to Schedule A (usually by an endorsement). Covered Risk 12 of the 2006 ALTA Loan Policy says:

> 12. The invalidity or unenforceability of any assignment of the Insured Mortgage, provided the assignment is shown in Schedule A, or the failure of the assignment shown in Schedule A to vest title to the Insured Mortgage in the named Insured assignee free and clear of all liens.

Curiously, few policyholders ask for an endorsement adding the assignment to Paragraph 4 of Schedule A.[11] Instead, the general practice is to insure the assignment with an ALTA 10-06. It doesn't add the assignment to Schedule A, so it does not invoke the coverage of Covered Risk 12. The endorsement coverage should be the equivalent of Covered Risk 12, but it doesn't specifically insure against the "invalidity or unenforceability" of the assignment as the Covered Risk does. However, insuring against the "failure of the following assignment to vest title to the Insured Mortgage in the Assignee" ought to cover its validity and enforceability. The ALTA 10-06 endorsement provides:

> 1. The name of the Insured at Date of Endorsement and referred to in this endorsement as the "Assignee" is amended to read: _______________.
>
> 2. The Company insures against loss or damage sustained by the Assignee by reason of:

> (1) if the stock, shares, memberships, or other equity interests of the grantee are wholly-owned by the named Insured,
>
> (2) if the grantee wholly owns the named Insured, or
>
> (3) if the grantee is wholly-owned by an affiliated Entity of the named Insured, provided the affiliated Entity and the named Insured are both wholly-owned by the same person or Entity;
>
> (F) any government agency or instrumentality that is an insurer or guarantor under an insurance contract or guaranty insuring or guaranteeing the Indebtedness secured by the Insured Mortgage, or any part of it, whether named as an Insured or not;
>
> (ii) With regard to (A), (B), (C), (D) , and (E) reserving, however, all rights and defenses as to any successor that the Company would have had against any predecessor Insured, unless the successor acquired the Indebtedness as a purchaser for value without Knowledge of the asserted defect, lien, encumbrance, or other matter insured against by this policy.

[11] Item 4 of Schedule A calls for:

> 4. The Insured Mortgage and its assignments, if any, are described as follows:

> a. The failure of the following assignment to vest title to the Insured Mortgage in the Assignee: ____________________________________;
>
> b. Any modification, partial or full reconveyance, release, or discharge of the lien of the Insured Mortgage recorded on or prior to Date of Endorsement in the Public Records other than those shown in the policy or a prior endorsement, except:________________________;

The ALTA 10.1 gives similar coverage. Sections 1 and 2.a in both endorsements are the same. Section 2 also dates the policy down to the Date of Endorsement as to the priority of the lien of the Insured Mortgage, notices of federal tax liens, bankruptcy or recorded modifications, releases, reconveyances or discharges of the lien of the Insured Mortgage. Section 2 of the ALTA 10.1 reads:

> 2. The Company insures against loss or damage sustained by the Assignee by reason of:
>
> a. The failure of the following assignment to vest title to the Insured Mortgage in the Assignee: ________________;
>
> b. Any liens for taxes or assessments that are due and payable on Date of Endorsement, except: __________;
>
> c. Lack of priority of the lien of the Insured Mortgage over defects, liens, or encumbrances other than those shown in the policy or a prior endorsement, except: _________;
>
> d. Notices of federal tax liens or notices of pending bankruptcy proceedings affecting the Title and recorded subsequent to Date of Policy in the Public Records and on or prior to Date of Endorsement, except: ________________________________;
>
> e. Any modification, partial or full reconveyance, release or discharge of the lien of the Insured Mortgage recorded on or prior to Date of Endorsement in the Public Records other than those shown in the policy or a prior endorsement, except: ____________________________.

Finally, both endorsements end with a creditors' rights exclusion against the risk that the assignment might be found to be a fraudulent conveyance or transfer or a preference. In addition, the endorsement requires endorsement of the note to the assignee, or "control" of the "transferable record" of the notes as these terms are defined by applicable electronic transactions laws. Since transfer of the note is not accomplished by a document recorded in the Public Records, the endorsement makes perfection of the transfer the responsibility of the Assignee.

7. Mortgage Modification

ALTA 11-06 (Mortgage Modification)

ALTA 11.1-06 (Mortgage Modification with Subordination)

The 2006 ALTA Loan policy does not include a Covered Risk for mortgage modifications like Covered Risk 12 for mortgage assignments. There are two ways to insure a mortgage modification. First, a datedown endorsement can add the modification to Item 4 of

Schedule A and insure the validity, enforceability and priority of the lien of the Insured Mortgage as modified as of the date of the endorsement.

However, a datedown is not the most efficient way to insure a modification. Datedowns began as a means of insuring construction advances made after the Date of Policy, *see* page 46. A datedown is indistinguishable from a insurance of a refinance, so it may be expensive. In addition, if the title examination turns out any matters, they might be excepted in Schedule B, although the Insured Mortgage may have priority over those matters because it was filed first. If the modification doesn't involve an additional advance or increase in the amount secured by the lien of the Insured Mortgage, it doesn't add value to the insurance coverage.

The alternative is an ALTA 11 series endorsement. An ALTA 11-06 insures the validity, enforceability and priority of the lien of the Insured Mortgage:

> The Company insures against loss or damage sustained by the Insured by reason of:
>
> 1. The invalidity or unenforceability of the lien of the Insured Mortgage upon the Title at Date of Endorsement as a result of the agreement dated ________________________, recorded ________________________ ("Modification"); and
> 2. The lack of priority of the lien of the Insured Mortgage, at Date of Endorsement, over defects in or liens or encumbrances on the Title, except for those shown in the policy or any prior endorsement and except: [Specify exceptions, if any]

If an exception appears in Section 2 of the endorsement, you should examine the exception with suspicion. Should the matter be added to Schedule B, or is it really subordinate to the lien of the Insured Mortgage? If it is really subordinate, the ALTA 11.1-06 is probably a better choice. It has a Section 3 for insuring against loss caused by "The following matters not being subordinate to the lien of the Insured Mortgage:" Adding the intervening matter to Section 3 leaves no question that the title insurance company insured the policyholder against any assertion of priority by that other creditor based upon the modification identified in Section 1 of the endorsement.

The ALTA 11 series endorsements end with a creditors' rights exclusion against loss or damage if the modification is held to be a preference, fraudulent conveyance or fraudulent transfer.

8. Aggregation

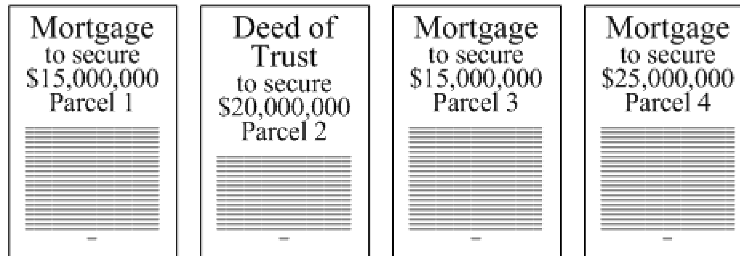
ALTA 12-06 (Aggregation)

a. Mortgage lien types

A group of liens in a financing may be created as a group of separate liens, or a group of aggregate liens. For illustration, let's imagine that we have a $75,000,000 financing that will be secured by four properties, each located in a different state.

i. Separate Liens.

Using separate liens, we could encumber our parcels 1 through four with mortgages limited to the value of a discrete note for each mortgage. Although the total of these liens is $75,000,000, the lender is limited to allocation on each site, as illustrated by these security instruments.

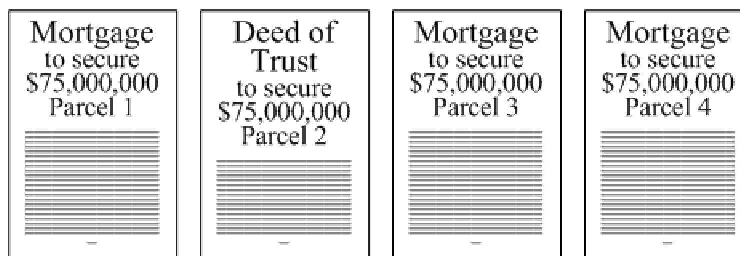


A competing creditor that examines the title to Parcel 1 will conclude that it is encumbered by a lien in the amount of $15,000,000. If Parcel 1 is worth more, say $25,000,000 the competing creditor expects equity in the amount of $10,000,000 to secure its extension of credit to the same borrower. Upon foreclosure of the first loan, the holder of this mortgage will be limited to the first $15,000,000 of proceeds. The mortgages do not each secure the aggregate loan amount of $75,000,000.

If these liens are "cross-defaulted" and "cross-collateralized, does that convert the liens to an aggregate lien? No. The mortgages are still limited to the amount they state that they secure. "Cross-default" simply means that a default on one mortgage is a default on all of them. That has no effect on the amount secured. If the mortgages are cross-collateralized, the lien may secure all four notes, but it is still limited by the amount the mortgage states that it secures. For example, if our lender accelerates the indebtedness on these loans and is partially paid, it may apply the payment to retire the notes on Parcels 1 & 2, and keep its liens on those parcels to secure the payment of the notes on Parcels 3 & 4. However, the lien on Parcel 1 remains at $15,000,000, not $40,000,000. The lien on Parcel 2 is still $20,000,000. By adding cross-default and cross-collateralization features, the lender has a more flexible security package, but it is not as flexible as an aggregate lien.

ii. Aggregate Liens.

The lender can also structure its security instruments as "blanket mortgages" to give competing creditors notice that each stands as security for a total indebtedness of $75,000,000 by showing that amount in the mortgage, instead of discrete values allocated to each site.



Each "blanket mortgage" must state the entire indebtedness that the lender seeks to secure with all four parcels. An aggregate lien is cross-defaulted and cross-collateralized by its

very nature since it is a single loan secured by four mortgages. A default on the single obligation is a default on all four mortgages, and all four mortgages secure the same obligation.

Structuring with an aggregate lien does have some weaknesses. It may take some persuasion to convince the clerk or registrar that any mortgage tax that may be due, is just due on an allocated amount when the mortgage shows an aggregate amount. It may take some extra effort, but we are usually successful. In addition, a blanket mortgage can defeat the isolation sought when a borrower is structured with Special Purpose Vehicles to hold title to the security. In many transactions this is overcome with an allocated first mortgage and a blanket second mortgage.

iii. Requiring an Aggregate Lien for Aggregate Title Insurance.

Does it make any sense to increase the Amount of Insurance[12] on Parcel 1 to $75,000,000 if the lender limited its own lien to $15,000,000? If we increase the Amount of Insurance to $75,000,000 on a separate lien for Parcel 1, are we misleading the insured into thinking that it successfully created an aggregate lien on all four properties? What happens if the lender, having separate liens, tries to recover substantially more than $15,000,000 on Parcel 1 after suffering a total failure of title on that site? Isn't the risk substantially greater once the lender seeks a recovery above its stated lien?

iv. Are There any Aggregate Ownership Interests?

There are few parallels in ownership or leasehold interest to an aggregate lien. Each parcel has its own discrete value. Of course, if a group of parcels are assembled into one parcel in a single site, you can argue that the values are now an aggregate, and may bear no relation to the values of the individual lots. Also, it's conceivable that a group of unconnected sites might have an independent value as a group. A cell tower net might be an example. If one site is lost, it could create a hole in cell coverage, reducing the value of the network.

b. Aggregation in title insurance

In ALTA Loan policies, the insured is not restricted from "shifting" coverage from an unaffected property to a property affected by a defect, lien or encumbrance insured against by the same policy to realize any appreciation in value of the affected property as an offset for a diminution in value of unaffected properties. By this form of aggregation of the coverage amounts, lenders can reduce their risk of loss due to inflation and fluctuations in real property values.

In our second illustration, if the title insurer issues a single policy for all four sites in the aggregate amount, the insured can shift the coverage from one site unaffected by title problems to another suffering a title loss. The aggregation of the title insurance coverage matches the aggregation of the lien of the mortgages.

Aggregation in a single loan policy works, but this form of aggregation often creates some problems. The policy forms used in some states may not be available in others, making

[12] Section 1(a) of the Conditions of the 2006 ALTA Owners and Loan Policies define the term as:

(a) "Amount of Insurance": The amount stated in Schedule A, as may be increased or decreased by endorsement to this policy, increased by Section 8(b) or decreased by Section 10 of these Conditions.

this solution unavailable in some transactions. In addition, reviewing large policies with numerous properties can be tedious. It may be a manageable solution for transactions with a limited number of properties, but it can be unmanageable for larger transactions. Many states require a licensed resident to countersign a title insurance policy, so in multi-state transactions, delivery of the loan policy can be delayed while the policy is passed from one office to the next for review and execution.

Issuing separate policies, each in the aggregate amount exposes the title insurer to questions about the premium and premium tax due. In a claim, the insured may expect a limit of $75,000,000 for each site, an aggregate of $300,000,000. This approach can be very confusing and expensive for all parties.

Of course, one might buy more insurance. For example, if the borrower is restricted to a loan not to exceed 80% of the value of the real estate, a loan policy issued for the full value of the property may provide enough cushion. Where the borrower is buying owner's policies as well as loan policies, this technique would cost no more than ordering loan policies at the allocated amount because the simultaneous premium rate would apply to both. Some lenders initially ask their borrowers to buy a policy on each property in the full amount of the aggregate loan, but this requirement is unnecessarily extravagant.

iii. Regulation of Aggregation

A few states impose restrictions on the use of aggregation in title insurance, and those restrictions are described in the following table.

FL	Aggregation is restricted to properties within Florida. Properties outside the state cannot be aggregated with properties in Florida.
PA	Aggregation is restricted to properties within Pennsylvania. Properties outside the state cannot be aggregated with properties in Pennsylvania.
DE	Aggregation is restricted to properties within Delaware. (As in PA).
TX	Texas allows interstate aggregation. All policies, however, must be issued simultaneously.

c. <u>The ALTA 12-06 Aggregation Endorsement</u>

In October 1996, the American Land Title Association adopted the ALTA 12-06 Aggregation Endorsement. It allowed each policy to state an allocated value for each property, making the process of defending allocated recording costs and taxes, and title insurance premiums much easier. It made local countersignatures easy and efficient. It overrode the value for the Amount of Insurance, so the Amount of Insurance on each mortgage was the aggregate amount, but it did not address how an aggregate amount would be treated in the application of those provisions in the Conditions. The endorsement listed the policies to be aggregated, and then provided:

> Notwithstanding the provisions of Section 8(a)(i) of the Conditions of this policy, the Amount of Insurance available to cover the Company's liability for loss or damage under this policy at the time of payment of loss hereunder

> shall be the aggregate of the Amount of Insurance under this policy and the other policies identified above. At no time shall the Amount of Insurance under this policy and the other policies identified above exceed in the aggregate $______________. Subject to the provisions of Section 10(a) of the Conditions of the policies, all payments made by the Company under this policy or any of the other policies identified above, except the payments made for costs, attorneys' fees, and expenses, shall reduce the aggregate Amount of Insurance by the amount of the payment.

On April 2, 2013, the ALTA 12-06 was changed to indicate how the aggregate coverage will be applied in the conditions. The list of policies in the first paragraph is unchanged but the following portion is much more detailed. It says:

2. The amount of insurance available to cover the Company's liability for loss or damage under this policy at the time of payment of loss shall be the Aggregate Amount of Insurance defined in Section 3 of this endorsement.
3. Subject to the limits in Section 4 of this endorsement, the Aggregate Amount of Insurance under these policies is $ ____________________.
4. Section 7(a)(i) of the Conditions of this policy is amended to read:

   7. OPTIONS TO PAY OR OTHERWISE SETTLE CLAIMS; TERMINATION OF LIABILITY

   In case of a claim under this policy, the Company shall have the following additional options:

   (a) to pay or tender payment of the lesser of the value of the Title as insured or the Aggregate Amount of Insurance applicable under this policy at the date the claim was made by the Insured Claimant, or to purchase the Indebtedness.

   (i) to pay or tender payment of the lesser of the value of the Title as insured at the date the claim was made by the Insured Claimant, or the Aggregate Amount of Insurance applicable under this policy together with any cost, attorneys' fees, and costs and expenses incurred by the Insured Claimant that were authorized by the Company up to the time of payment or tender of payment and that the Company is obligated to pay; or . . .
5. Section 8(a) and 8(b) of the Conditions of this policy are amended to read:

   8. DETERMINATION AND EXTENT OF LIABILITY

   This policy is a contract of indemnity against actual monetary loss or damage sustained or incurred by the Insured Claimant who has suffered loss or damage by reason of matters insured against by this policy.

   (a) The extent of liability of the Company for loss or damage under this policy shall not exceed the least of

   (i) the Aggregate Amount of Insurance,

   (ii) the Indebtedness,

(iii) the difference between the value of the Title as insured and the value of the Title subject to the risk insured against by this policy, or

(iv) if a government agency or instrumentality is the Insured Claimant, the amount it paid in the acquisition of the Title or the Insured Mortgage in satisfaction of its insurance contract or guaranty.

(b) If the Company pursues its rights under Section 5 of these Conditions and is unsuccessful in establishing the Title or the lien of the Insured Mortgage, as insured, the Insured Claimant shall have the right to have the loss or damage determined either as of the date the claim was made by the Insured Claimant or as the date it is settled and paid.

6. Section 10 of the Conditions of this policy is amended to read:

10. REDUCTION OF INSURANCE; REDUCTION OR TERMINATION OF LIABILITY

(a) All payments under this policy, except payments made for costs, attorneys' fees, and expenses, shall reduce the Aggregate Amount of Insurance by the amount of the payment.

(b) However, any payments made prior to the acquisition of Title as provided in Section 2 of these Conditions shall not reduce the Aggregate Amount of Insurance afforded under this endorsement except to the extent that the payments reduce the Indebtedness.

(c) The voluntary satisfaction or release of the Insured Mortgage shall terminate all liability of the Company under this policy, except as provided in Section 2 of these Conditions, but it will not reduce the Aggregate Amount of Insurance for the other policies identified in Section 1 of this endorsement.

The term "Amount of Insurance" is used in several of the Conditions, but the old ALTA 12-06 did not specify how the Aggregate Amount of insurance would interact with them. If the Amount of Insurance defined in Schedule A is applied, it defeats aggregation. If the aggregate amount is applied in some circumstances, that makes the insurance unworkable. By modifying Conditions 7, 8 and 10, the aggregation becomes practical.

When the parcels are scattered in different areas it has been the custom to open the title order for individual policies for each parcel with an office in that parcel's locality. Instead of a single policy, individual policies are generally issued. It's easier on everybody.

As we have seen, individual policies for each parcel can be produced more quickly and accurately and the coverages can be reviewed more easily than a single policy, but the amount of coverage suffers by losing the ability to aggregate amounts. Adding an ALTA 12 aggregation endorsement to each single policy for all parcels or individual policies restores the ability to shift coverage among the properties, but without sacrificing the effect of using a single policy. Review

is simplified because the exceptions for a particular property are the only exceptions that will appear in the policy for that property.

9. Leaseholds

ALTA 13-06 Leasehold Owners and ALTA 13.1-06 Leasehold Loan

The original 1975 Leasehold policies were designed with a simple operating lease in mind. If the holder of leased space was dispossessed as a result of a defect in either the landlord's title or the lease itself, the title policy would indemnify the holder for the increased cost of leasing an alternate space, and give some "Miscellaneous Items of Loss" as well. The ALTA may have seen the market in 1975 as the market for simple operating leases of offices and store bays in shopping centers, but leaseholders in those markets did not sense enough coverage in the leasehold policy to make it a worthwhile hedge to the risks they faced. Consequently, the ALTA leasehold policy was never popular. The policy missed the developing markets in real estate leasing.

Leases have been used as a financing tool for decades. Sale-leaseback transactions have been commonplace at least since the 1960's in my own experience. In the last two decades of the twentieth century, leasing transactions have become even more significant in financing real estate transactions. We see leveraged leasing of build to suit projects, ground leases with tenant build to suit projects, and synthetic leases, just to name some of the recent applications.

a. Definitions

The ALTA 13 begins by adding seven definitions to the policy. Here is a look at Section 1 of the ALTA 13[13]:

1. As used in this endorsement, the following terms shall mean:
   a. "Evicted" or "Eviction": (a) the lawful deprivation, in whole or in part, of the right of possession insured by this policy, contrary to the terms of the Lease or (b) the lawful prevention of the use of the land or the Tenant Leasehold Improvements for the purposes permitted by the Lease, in either case, as a result of a matter covered by this policy.
   b. "Lease": the lease described in Schedule A.
   c. "Leasehold Estate": the right of possession for the Lease Term.
   d. "Lease Term": the duration of the Leasehold Estate, including any renewal or extended term if a valid option to renew or extend is contained in the Lease.
   e. Personal Property": property, in which and to the extent the Insured has rights, located on or affixed to the Land on or after Date of Policy that by law does not constitute real property because (i) of its character and manner of attachment to the Land and (ii) the property can be severed

[13] This is from the 04-02-2012 revision of the endorsement.

from the Land without causing material damage to the property or to the Land.

f. "Remaining Lease Term": the portion of the Lease Term remaining after the insured has been Evicted.

g. "Tenant Leasehold Improvements": Those improvements, in which and to the extent the Insured has rights, including landscaping, required or permitted to be built on the land by the Lease that have been built at the insured's expense or in which the insured has an interest greater than the right to possession during the Lease Term.

The Leasehold policy limited its definition of "Lease" as "subject to any provisions contained in the Lease which limits the right of possession." The limitation was dropped because it received so much resistance from customer groups consulted in the drafting process. Although title insurers do not intend to protect policyholders from the consequences of their own agreements, the limitation in policy definition of "Lease" was not the only provision giving the title insurer this protection in the policy. The insurer is also protected by the "acts of the insured" Exclusion 3(a).

b. Valuation

Although the valuation provision of the ALTA 13 does not appear until Section 3 of the endorsement, it is the most significant change in the ALTA leasehold coverages.

3. Valuation of Estate or Interest Insured

If in computing loss or damage it becomes necessary to value the Title, or any portion of it, as the result of an Eviction of the Insured, then, as to that portion of the Land from which the Insured is Evicted, that value shall consist of the value for the Remaining Lease Term of the Leasehold Estate and any Tenant Leasehold Improvements existing on the date of the Eviction. The Insured Claimant shall have the right to have the Leasehold Estate and the Tenant Leasehold Improvements affected by a defect insured against by the policy valued either as a whole or separately. In either event, this determination of value shall take into account rent no longer required to be paid for the Remaining Lease Term.

There is no method specified for valuing either the Leasehold Estate or the Tenant Leasehold Improvements. It does recognize that the Leasehold Estate and the Tenant Leasehold Improvements can be valued independently. In short, the methods for valuing a loss and its deductions under this new endorsement are left to negotiation between the insured and title insurer when adjusting a claim.

c. Co-insurance

Most leasehold interests are shorter than 99 years; so applying the co-insurance provisions of Section 7(b) makes little sense in the leasehold endorsement. The values we must use for insuring most leasehold estates are imprecise, at best. We don't have a convenient, arms length purchase price as we do in most real estate conveyances. In the development of the ALTA 13, the Forms Committee made the co-insurance provision inapplicable to Leasehold Estates. It provided:

2. The provisions of subsection (b) of Section 7 of the Conditions and Stipulations shall not apply to any Leasehold Estate covered by this policy.

However, Section 2 of the ALTA 13 may mislead the incautious insured. It does provides that the co-insurance limitations on coverage contained in Section 7(b) of the 1992 ALTA Owners policy do not apply to the Leasehold Estate, but does not make Section 7(b) inapplicable to Tenant Leasehold Improvements. If Leasehold Estates and Tenant Leasehold improvements are independent primary items of loss, then Section 7(b) still must apply to the Tenant Leasehold Improvements. This discrepancy was corrected with the adoption of the 2006 ALTA Owners policies that do not have the co-insurance limitation. As a result, Section 2 of the original endorsement was dropped in the ALTA 13-06.

There was never a provision corresponding to Section 2 of the ALTA 13 in the ALTA 13.1 because ALTA Loan policies never had co-insurance provisions. Consequently, there was no need to include a corresponding co-insurance section in the ALTA 13.1.

d. Tenant Leasehold Improvements

As we have seen, Section 1(g) of the ALTA 13 added a definition of Tenant Leasehold Improvements to protect the insured's investment in these assets. The definition encompasses any improvements, including landscaping, taking a lead from the ALTA 9 Endorsement that protects interests in "lawns, shrubbery or trees" in several sections. Recognizing landscaping as "improvements" is not unique, but certainly a new development for leasehold coverages.

Of course, as we saw on page 33, Section 2 of the ALTA 13-06 brought a recognition of damage or loss to the Tenant Leasehold Improvements to leasehold title insurance. In addition, supporting the conclusion that loss to Tenant Leasehold Improvements is a primary coverage, Section 2 empowers the insured to elect whether to have the Leasehold Estate and Tenant Leasehold Improvements valued together or separately. However, there is one other provision for valuation of Leasehold Tenant Improvements that was added in the ALTA 13-06.

Determining the value of Tenant Leasehold Improvements becomes really difficult if the tenant is in the process of building a significant structure on its leasehold when its right to possession is challenged. This isn't just a case of bad luck. The risk of a challenge to title is greatest during the construction of improvements because the evidence of the construction announces the tenant's claim to the land to any who see it.

An appraiser will not give a high value to incomplete improvements. Indeed, many times an incomplete project may actually reduce the appraised value of land. If the incomplete structure must be demolished as useless, the cost of removal must be deducted from the market value of the raw land. Even if the construction is only interrupted, it often costs substantially more to resume and finish the construction than it would if the construction had progressed without the interruption. If a leasehold was insured with either a leasehold or owner's policy, the title insurer might reduce or deny a claim for the value of the tenant's investment in the leasehold improvements by asserting that the incomplete project had little or no value.

This problem with valuation of improvements under construction is not confined to leasehold estates. It applies to any project under construction. Title insurance had never addressed this problem in a standard policy or endorsement coverage until the ALTA 13-06 addressed it in Section 3(g) of the Additional Items of Loss:

> 4. Additional items of loss covered by this endorsement:
>
> If the insured is Evicted, the following items of loss, if applicable, shall be included in computing loss or damage incurred by the insured, but not to the extent that the same are included in the valuation of the estates or interests insured by this policy. . . .
>
> g. If Tenant Leasehold Improvements are not substantially completed at the time of Eviction, the actual cost incurred by the insured, less the salvage value, for the Tenant Leasehold Improvements up to the time of Eviction. Those costs include costs incurred to obtain land use, zoning, building and occupancy permits, architectural and engineering fees, construction management fees, costs of environmental testing and reviews, landscaping costs and fees, costs and interest on loans for the acquisition and construction.

Section 3(g) allows the insured to recover its investment in the construction, as well as those "soft costs" it expressly lists. It significantly expands the measure of damages under a title insurance policy, and the only reason for confining this coverage to leasehold estates is the greater difficulty that title insurers have experienced in breaking into the leasehold title market. We should expect pressure to migrate this type of coverage into fee ownership development transactions as well.

e. The "Eviction" Trigger

In the process of drafting this endorsement, several of those involved questioned the use of the terms "Evicted" and "Eviction" as the trigger for coverage under the ALTA 13. It was criticized as sounding too rigid and might suggest that loss under the endorsement required a judicial eviction. The word "ouster" was also considered, but rejected because the definitions of "ouster" included denial of possession to a rightful owner. It didn't fit. To resolve this concern, the definition was crafted to avoid a rigid construction for the term.

Section 15 of the old leasehold Policy also used the terms "evict" and "eviction," though it did not define them. The definition added to the ALTA 13 in Section 1(a) of the endorsement should allay any concerns that the words imply a requirement for a judicial proceeding:

> a. "Evicted" or "Eviction": (a) the lawful deprivation, in whole or in part, of the right of possession insured by this policy, contrary to the terms of the Lease or (b) the lawful prevention of the use of the land or the Tenant Leasehold Improvements for the purposes permitted by the Lease, in either case, as a result of a matter covered by this policy.

Under this definition "Eviction" may be either a lawful deprivation of the right of possession under the lease or the lawful prevention of the use of the land "for the purposes permitted by the lease." That's an additional nugget for the insured. Title insurance policies do not usually insure land use issues without an endorsement like the ALTA 3.1-06, but the ALTA 13-06 requires a prudent title insurance underwriter to compare the uses specified in a lease with the land use regulations that apply to the land to avoid losses under this definition.

The definition does create a coverage trigger. You must have an eviction before you can show a loss under this policy. It is important to recognize that this is no mere definition, even though it is included in Section 1 of the endorsement.

f. Additional Items of Loss

When the first Leasehold policies were adopted in 1975, their best feature was a set of unusual consequential damage provisions in Section 15 that were entitled "Miscellaneous Items of Loss" On reflection, the Forms Committee twenty five years later decided that it could improve the title. The old caption in the policy suggests that these provisions are "miscellaneous," almost an afterthought. However, they were revolutionary for their time, at least, they were revolutionary for the realm of title insurance. Title insurers avoid recognizing consequential damages as "loss" because consequential damages are so open ended. The new title is just a revision of the old, but it does invite the policyholder to read Section 3 of the ALTA 13-06 to find those 'additional' coverages.

It should be no surprise that these consequential damage provisions were kept in the ALTA 13-06. They were edited for some minor grammatical changes, to reflect the new definitions of terms in Section 1 of the ALTA 13, and to include the addition of Leasehold Tenant Improvements into the coverage. The grammatical changes were fairly harmless, like the substitution of "that" for "which" in Sections 3(c) & (e). With the addition of new definitions in Section 1, it makes sense that they would be incorporated wherever they would fit in the leasehold coverage. The definition of "personal property" formerly found in Section 15(a) of the Leasehold Policy was edited and moved to Section 1(e) of the ALTA 13.

Section 15(a) of the old "Miscellaneous Items of Loss" allowed payment of the costs of relocating personal property removed from the insured land to a replacement leasehold, but the title insurer would only pay for cost of transportation for the initial twenty-five miles. The idea was to limit the insured to relocations in the same area as the insured land. Title insurers did not want to be caught paying for transportation over long distances. I think this meant that the title insurer would pay for all the removing and relocating operations that take place at the origin and destination, but if the distance between the two exceeds twenty-five miles, the insurer would pay for the first twenty five miles of travel and the insured must pay for any additional travel.

Section 15(a) expanded the radius from twenty-five to one hundred miles. There are perhaps two reasons for this wider radius. First, title insurers have experienced very little, if any, losses based on Section 15(a), so the Forms Committee saw little risk in expanding the range to one hundred miles. Secondly, a one hundered mile radius is more attractive to title insurance consumers than a twenty-five mile radius, and the Forms Committee saw an opportunity to make the ALTA 13-06 more appealing than its predecessor.

Expanding from a twenty-five mile radius to a one hundred mile radius is a substantive change, but not very material. If our experience with Section 15(a) of the Leasehold Policy is any measure, few, if any, policyholders will realize a benefit from the change. Of course, all policyholders are better off for the change because we cannot identify that few at the outset. Some customers in the past have asked for changes to old Section 15(a) because it didn't meet their needs. A jet engine rework facility located at a south Florida airport many years ago asked for a change because the business required a location on the ramp at an airport. The customer was concerned that no suitable site might be located within twenty-five miles. We agreed to modify Section 15(a) to encompass a move anywhere within the state.

For title insurance customers with bond leases with "hell or high water" provisions that require the lessee to continue paying its 'rent' even after it has been evicted from the premises, Section 3(c) provides protection against that risk. I am mildly astonished that so few of these customers raise this issue and seek this coverage. Many, in recent years, have demanded ALTA Owner's Policies instead of leasehold policies, and have let the coverage slide in making the requirement. It should not be necessary with the ALTA 13-06.

The ALTA also added two new provisions to the Additional Items of Loss in the ALTA 13-06. We examined the valuation provisions for a new project under construction in new Section 4(g) in the discussion of Leasehold Tenant Improvements on page 35. Section 3(f) is also new, and reimburses the policyholder for the expenses to get a replacement Leasehold Estate. Like Section 3(g), Section 3(f) introduces the prospect of including "soft costs" into the computation of an insured's damages.

The ALTA 13-06 and 13.1-06 leasehold endorsements were the basis for creating the ALTA 36 -06 and 36.1-06 Energy Project Endorsements, and in that process, a number of changes were made that the Forms Committee thought should be retrofitted to the basic ALTA 13s for the April 2, 2012 revision

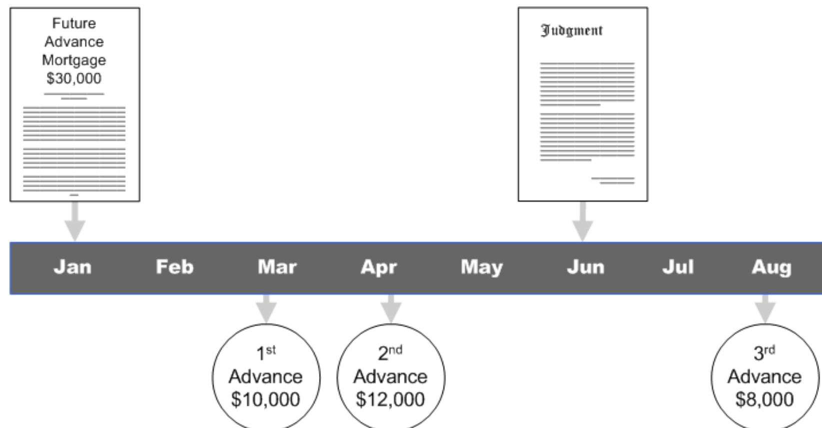
The definition of "Personal Property was amended to include property "in which and to the extent the Insured has rights" so absolute ownership is not required. Now it either can be located on or affixed to the land, but by law doesn't constitute real property. The definition of Tenant Leasehold Improvements was also modified to include those "in which and to the extent the Insured has rights."

The Valuation Section 2 and additional items of loss Section 3 were also expanded to include a portion of the land so eviction from all of the land is not required. There were other tweaks to the endorsement. Finally, a new Section 4 was added to exclude losses from remediation of environmental damage or contamination.

10. Future Advances

ALTA 14-06 (Priority),
ALTA 14.1-06 (Knowledge),
ALTA 14.2-06 (Letter of Credit) and
ALTA 14.3-06 (Reverse Mortgage)

Let's begin by illustrating the future advance issue with a simple example. A borrower gives its lender a future advance mortgage to secure $30,000 in January. The lender advances $10,000 in March and another $12,000 in April. A competing judgment lien is perfected against the borrower in June. The lender makes a final advance of $8000 in August. What are the issues created by this structure? Advances 1 & 2 should be safe in any state. That third advance might have priority over the judgment lien, or not.



With an ALTA loan policy, the future advance lender has no protection for the lien of the mortgage as security for these future advances. The loan policy was designed to insure mortgages securing conventional term loans, so it does not insure that the lien of the mortgage either:

i. secures future advances made to or on behalf of the borrower; or

ii. has priority over matters intervening in the records between the recording of the mortgage and the date of a future advance.

It might seem that these are deficiencies in the policy itself that would be better addressed by amending the policy, but many states impose requirements on the mortgage form if it is expected to secure future advances. An underwriter must first decide if the mortgage meets state requirements before it is appropriate to insure future advances

In addition, the priority rules for future advances vary from state to state. A title insurance underwriter must also satisfy itself that the coverage matches the state priority rule before insuring advances. Before we address the ALTA future advance endorsements, let's take a brief look at the risks and those policy provisions that apply to future advances, so we will understand why we must have at least three forms of endorsement.

a. Protective Advances

A "protective advance" is an expenditure by the lender for:

(i) the expenses of foreclosure and any other costs of enforcement;

(ii) the amounts advanced to assure compliance with laws or to protect the lien or the priority of the lien of the Insured Mortgage before the acquisition of the estate or interest in the Title;

(iii) the amounts to pay taxes and insurance; and

(iv) the reasonable amounts expended to prevent deterioration of improvements.

These protective advances are not made to or on behalf of the borrower, but are made by the lender to preserve the value of the security where the borrower is in distress. If the lender fails to make a protective advance, it might lose its security to a tax foreclosure, or witness a decline in value as the improvements fall into disrepair. Also, if the lender fails to police its

security, its neglect may harm junior creditors and the borrower, as well. So most states allow these advances, even if the mortgage itself gives no notice that the lender might advance funds in the future.

If the third advance in the illustration on page 37 was not made to the borrower, but was a protective advance, does the title policy insure that the mortgage secures it? Perhaps.

Most title insurers thought the priority of protective advances were insured in the 1992 and earlier policies because Section 8(d) of the policy's Conditions and Stipulations said:

> The company shall not be liable for: (i) any indebtedness created subsequent to Date of Policy except for advances made to protect the lien of the insured mortgage and secured thereby and reasonable amounts expended to prevent deterioration of improvements . . . .

Section 8(d) was backhanded coverage at best, and it didn't mention priority. In addition, the 1992 ALTA Loan policy included a description of protective advances, without mentioning priority, in the amount of insurance defined in Section 2(c)(ii):

> (c) Amount of Insurance. The amount of insurance after the acquisition or after the conveyance shall in neither event exceed the least of:
>
> (i) the Amount of Insurance stated in Schedule A;
>
> (ii) the amount of the principal of the indebtedness secured by the insured mortgage as of Date of Policy, interest thereon, expenses of foreclosure, *amounts advanced pursuant to the insured mortgage to assure compliance with laws or to protect the lien of the insured mortgage prior to the time of acquisition of the estate or interest in the land and secured thereby and reasonable amounts expended to prevent deterioration of improvements, but reduced by the amount of all payments made*; or
>
> (iii) the amount paid by any governmental agency or governmental instrumentality, if the agency or instrumentality is the insured claimant, in the acquisition of the estate or interest in satisfaction of its insurance contract or guaranty. [Emphasis added]

If this was insurance for the priority of protective advances, it could have been a lot clearer. The issue became more clouded when the 2006 ALTA Loan Policy dropped Section 8(a) altogether, and shifted the provisions of 1992 Section 2(c)(ii) of the Conditions and Stipulations into Section 1(d)(vi) through (ix) of the 2006 Conditions, defining "Indebtedness."

> (d) "Indebtedness": The obligation secured by the Insured Mortgage including one evidenced by electronic means authorized by law, and if that obligation is the payment of a debt, the Indebtedness is the sum of . . .
>
> (vi) the expenses of foreclosure and any other costs of enforcement;
>
> (vii) the amounts advanced to assure compliance with laws or to protect the lien or the priority of the lien of the Insured Mortgage before the acquisition of the estate or interest in the Title;
>
> (viii) the amounts to pay taxes and insurance; and
>
> (ix) the reasonable amounts expended to prevent deterioration of improvements;

> but the Indebtedness is reduced by the total of all payments and by any amount forgiven by an Insured.

The ALTA takes the position that the reference to future advances (the amount of the principal disbursed subsequent to Date of Policy) in Section 1(d)(ii) doesn't insure the priority of future advances because no Covered Risk refers to future advances. As a result, a policyholder must order an ALTA 14 series endorsement to insure future advances.

The very same argument applies to deny priority coverage for protective advances under Section 1(d) (vi) through (ix), although I think this was an oversight in drafting the new policy. As we shall see, the ALTA 14 series includes protective advances in the definition of "Future Advance," so the problem is cured if the policy includes an ALTA series endorsement. This omission should be corrected in a revision of the policy.

b. Does the policy insure that the mortgage secures advances to or on behalf of the borrower?

A mortgage may be silent about the potential for future advances, contain a future advances provision or contain a 'dragnet' provision. However, it would be imprudent to insure any but protective advances if the mortgage gives no notice that it secures future advances.

We can distinguish between future advance provisions and 'dragnet' provisions. A future advance provision indicates that the note or loan agreement establishes the potential for advances in the future that will be secured by the mortgage. A revolving credit line or home equity loan is a familiar example of a future advance loan.

A 'dragnet' provision may appear in a mortgage with or without a future advance provision. It may indicate that the mortgage secures all debts, past, present and future that the borrower may owe the lender. It is named for its ambitious scope. Courts tend to be more critical of mortgages with dragnet provisions than mortgages with typical future advance features because of the potential overreach. *Home Federal Bank FSB of Middlesboro v. First National Bank of Lafollette*, 110 S.W. 3rd 433 (Tenn. App. 2002); *see*, *Uransky v. First Federal Savings and Loan Association of Fort Meyers*, 684 F2.d 750 (11th Cir. 1982).

Even if the mortgage includes a 'dragnet' provision, it can only secure advances that are of the same kind and nature as the loan secured. For example, it cannot secure both the outstanding balance of the loan and the borrower's liability to the mortgagee for unrelated tortious conduct.

i. The risk that the mortgage does not secure advances to the borrower.

So, at a minimum, a mortgage must give other creditors notice that it secures future advances and it must state the maximum indebtedness it secures. These requirements may be set by statute or expressed in case decisions addressing future advances or dragnet provisions. If a mortgage fails to indicate that it will secure future advances and set a maximum amount, a court is unlikely to extend its protection for subsequent advances to or on behalf of the borrower. In addition, some state statutes require additional provisions in the mortgage or deed of trust form before it will secure future advances. These may be simple captions at the top of the mortgage. In most states the mortgage should also specify that it secures a 'credit line' or 'readvances' if the loan is a revolving credit line.

Even if a mortgage meets all state requirements for future advances, the lender cannot proceed with advances after a petition in bankruptcy has been filed by or on behalf of the borrower. The automatic stay under 11 U.S.C. 362 will bar the mortgage from securing post-petition advances, unless the bankruptcy court authorizes them. There is an exception to this rule for payments made under a letter of credit, but I will address it separately on page 44.

There are some other obstacles to future advances. Mortgage recording taxes can make revolving credit lines unworkable if the tax is due on the aggregate amount disbursed. In New York, one can pay mortgage tax on the maximum balance to be secured by a commercial mortgage for more than $3,000,000, and record the mortgage. The state will not seek any more tax unless the mortgage is modified or foreclosed. If the parties modify the mortgage, they must disclose the aggregate amount disbursed in the 255 affidavit, and pay tax for the aggregate in excess of the maximum amount stated in the mortgage. *See*, N.Y. TAX LAW §255. If the lender forecloses, it must also pay tax on the excess of the aggregate over the maximum balance on which the original tax was paid. However, New York will not seek extra tax just to record a satisfaction of the mortgage, even if the aggregate amount disbursed exceeded the maximum balance on which the original tax was paid. That potential mortgage tax liability for mortgage modifications and foreclosures chills the market for commercial future advance mortgages in New York.

A few states have laws that automatically release the lien of the mortgage if the outstanding principal balance of the loan reaches zero. A lender can usually defeat these statutes by adding a provision for securing advances following a zero balance of principal indebtedness. *Martin v. Fairburn Banking Company*, 463 S.E. 2d 507 (Ga. App. 1995).

Some states impose a time limitation for making secured advances. For example, Florida and New York set a limit of twenty years. North Carolina limits the protection of the lien of the mortgage to advances made within fifteen years from the date of the mortgage. South Dakota sets a maximum of five years.[14]

ii. Validity and Enforceability of the Lien of the Mortgage to Secure Advances

Most future advance lenders expect, as a minimum, that their title insurance policy would insure that their mortgage or deed of trust would *secure* advances made after the date of the policy. Although all states recognize that mortgages or deeds of trust can *secure* future advances or obligations, as we have seen, there are some circumstances where security may be lost. So, as basic as security for future advances may appear, a lender with an unmodified ALTA loan policy will not have coverage for any advances because no Covered Risk insures the validity or enforceability of the lien of the Insured Mortgage as security for Advances

A title insurer can insure that advances are secured by the lien of the insured mortgage, but it should first review the mortgage or deed of trust to assure itself that the mortgage contains those provisions required by state law to secure future advances.

[14] FLA. STAT. §697.04; N.Y. REAL PROPERTY LAW §281; N.C. GEN. STAT. §45-68; S.D. CODIFIED LAWS §44-8-26.

c. <u>Priority of advances</u>

It's not enough to insure that an advance is secured by the mortgage, a prudent lender also wants insurance of the priority that advance will enjoy against liens junior to the mortgage. If we refer back to our example on page 37, assuming that we have a future advance mortgage, the advances in March and April are pretty safe. It's that August advance that might be subordinate to the judgment lien. To evaluate its priority, we must know the answers to two questions:

i. Are the advances optional or obligatory?

ii. If the advances are optional, what priority rule applies?

i. Optional or obligatory?

To be an obligatory advance, the lender must have a duty to make the advance, even if it would prefer to decline advancing the disbursement. If an advance is optional, the lender has a choice. It may advance or not.

If the borrower is financially healthy, the lender will readily advance because it is in the business of making loans. If it thinks the borrower is in distress, it may decline a request for an advance, if it can. These distinctions may look clear, but there are problem areas. Although a lender may characterize its advances as obligatory, few will 'obligate' themselves to advance funds without also requiring the borrower to meet certain financial tests before each advance. If the borrower must pass a test before each advance, is the advance really obligatory or is it optional? Just when the lender needs the priority of obligatory advances, it may lose them where the borrower fails the tests set up in the loan documents.[15]

ii. State Priority Rules

Many states have statutes or case law that apply the priority of the mortgage itself to any advance, whether obligatory or optional and whether or not the future advance lender has received notice of an intervening lien. The ALTA 14 series refers to this kind of priority as 'advance priority.' In some cases, it appears that a statute was intended to create this result, but it might be poorly worded, so there is some risk that a court may construe it as creating notice priority. However, where this rule applies, it is unnecessary to distinguish between optional advances and obligatory advances.

'Priority' is a bit of a misnomer. The advances don't have priority over everything, but they are superior to advances made under notice priority rules. A priority advance may still be subject to certain risks:

- Real estate taxes and assessments. This should be no surprise because any amount secured by the mortgage is subject to taxes and assessments.
- A federal tax lien under 26 U. S. C. §6321 filed more than 45 days before the advance.
- Federal or state environmental protection liens.

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[15] *See*, Colavito: *Credit Line Mortgages – Problems and Challenges*, Lawyers Supplement to the GUARANTOR (Chicago Title Insurance Company, January/February 1985).

- In some states, specified risks like judgments or mechanic's liens may take priority over full priority advances.[16]

iii. Notice priority

The distinction between 'priority' and 'notice priority' is quite simple. An advance in a notice priority state may be subject to all of the risks that it would be subject to in a full priority state, but it is also subject to a lien perfected after the mortgage if the intervening lienor gives either actual or written notice of the intervening lien to the future advance lender. If we look at our simple future advance example on page 37, the third advance would take priority over the intervening judgment lien in a full priority state, but it would be subject to the judgment lien in a notice priority state if the judgment creditor gives the lender notice of its judgment. The first two advances would take priority over the judgment in both cases. Lenders see the 'full priority' risks listed above as unpleasant but manageable. However, losing priority to a competing creditor is especially galling.

The real problem here is determining if notice is effective. When the notice rule evolved, most mortgage lenders were local, so a competing creditor could take its notice to the bank building, and leave confident that it had upset the priority of any subsequent advances. With national lenders, it is conceivable that some director, officer employee or agent might learn of facts that could upset the priority of an advance, but not know anything about the significance of those facts to a future advance loan.

iv. Exclusion 3(d)

In addition to insurance that advances are *secured* by the insured mortgage, a lender will request coverage insuring that the *priority* of each advance will relate back to the mortgage and be superior to any matter intervening between the time the mortgage was recorded and the time the advance is made. Exclusion 3(d) of the Exclusions from Coverage expressly excludes priority coverage for advances from the ALTA policy forms. If it remains unmodified in the policy, there will be no coverage against loss of priority of future advances as a result of matters that attach or are created after the policy date (which should be the date the mortgage is recorded).

ALTA loan policies - Exclusion 3(d) of the Exclusions from Coverage:

The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorneys' fees or expenses which arise by reason of: ...

3. Defects, liens, encumbrances, adverse claims or other matters: ...

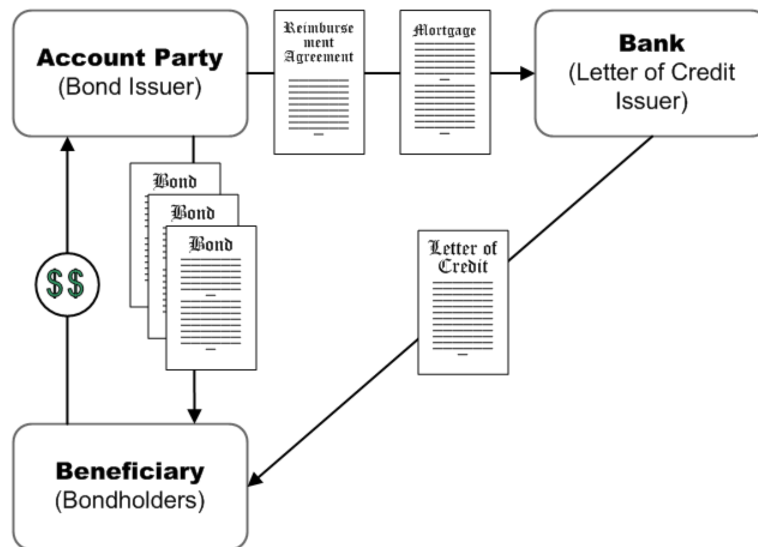
   (d) attaching or created subsequent to Date of Policy (however, this does not modify or limit the coverage provided under Covered Risk 11 [*mechanic's liens and street assessments*], 13 [*specified preferences*], or 14 [*gap coverage*]); ...

[16] *See*, D.C. CODE ANN. §42-2303; S.C. CODE ANN. §29-3-50; VT. STAT. ANN. tit. 27 §410; VA. CODE ANN. §55-58.2; W. VA. CODE §38-1-14.

d. Letters of credit and surety bonds.

Some disbursements enjoy general recognition as obligatory, but, as we have seen, others may be in doubt. The disbursements universally recognized as obligatory beyond question arise from standby letters of credit and surety bonds. They play by rules not generally applicable to future advances.

A letter of credit transaction involves three parties, the letter of credit issuer, its customer who asks for the letter of credit and a third party contracting with that bank customer who will not accept the customer's credit for a transaction. It wants the bank's credit instead. Let's imagine a simple bond transaction, where the bondholders are unwilling to accept the bond issuer's credit, and don't want the trouble of foreclosing as a remedy if the bond issuer defaults. The bank will issue its letter of credit and take a mortgage to secure its customer's reimbursement obligation. The transaction will diagram like this:



If the Account Party defaults in its obligation to the bondholders, the advance, if you want to call it that, will be paid to the bondholders when they present the letter of credit to the bank. No money will be disbursed to the Account Party, although it is the real borrower. This structure gets favored treatment in bankruptcy and for federal tax liens because the bank has an absolute obligation to pay if the letter of credit is duly presented to it.

i. Bankruptcy

Disbursing after presentment of a letter of credit is not a violation of the automatic stay in bankruptcy when the account party is in bankruptcy. The letter of credit is an obligation of the bank, not an obligation of the account party. After all, that was the point when the beneficiary or principal insisted on the letter of credit in the first place. That means the draw is not stayed, even if the reimbursement obligation securing the letter of credit or surety bond is secured by a lien on property in the bankrupt's estate.

> It is well established that a letter of credit and the proceeds therefrom are not the property of the debtor's estate under 11 U.S.C. § 541. [*citations omitted*] When the issuer honors a proper draft under a letter of credit, it does so from its own

assets and not from the assets of its customer who caused the letter of credit to be issued. As a result, a bankruptcy trustee is not entitled to enjoin a post petition payment of funds under a letter of credit from the issuer to the beneficiary, because such a payment is not a transfer of debtor's property (a threshold requirement under 11 U.S.C. § 547(b)). *Kellogg v. Blue Quail Energy, Inc.* (*In re Compton Corp*.), 831 F.2d 586 at 589 (5th Cir. 1987); *See also*, *Willis v. Celotex Corp.*, 970 F.2d 1292, *modified*, 978 F.2d 146 (4th Cir. 1992).

ii. Federal tax liens

Federal tax liens, established under the INTERNAL REVENUE CODE, 26 U. S. C. § 6321, do not take priority over an "obligatory disbursement agreement" 26 U. S. C. § 6323(c)(1)(A)(3). An ‘obligatory disbursement agreement’ is defined in 26 U.S.C 6323(c)(4)(A) as:

> The term "obligatory disbursement agreement" means an agreement (entered into by a person in the course of his trade or business) to make disbursements, but such an agreement shall be treated as coming within the term only to the extent of disbursements which are required to be made *by reason of the intervention of the rights of a person other than the taxpayer. (Emphasis added).*

The demand for payment by a beneficiary or principal under a standby letter of credit or surety bond constitutes the ‘intervention of the rights of a person other than the taxpayer’, so disbursement of the funds keeps its priority over a federal tax lien. A state definition of ‘obligatory advance’ or rule that optional advances are treated as if they were obligatory advances has no effect on §6323. Only advances satisfying §6323(c) take priority over previous federal tax liens.

Since a letter of credit mortgage is valid, enforceable and loses no priority even if the account party is bankrupt, or the IRS has filed a tax lien against its property, the title insurance for letters of credit will be substantially cleaner than for an obligatory advance of funds to the borrower.

If an advance does not meet the standards expressed in 26 U.S.C 6323(c), they are considered optional. 26 U. S. C. § 6323(d) gives optional advances a 45-day grace period after a federal tax lien is filed. After 45 days have elapsed after filing a lien, any optional advance is subordinate to the tax lien.

e. Insuring Future Advances

Caveat: Lenders often order title insurance for a loan that includes some future advance features, but they never disclose those features. They trust the title policy to protect the advances without realizing that it must be modified to protect them. This can occur in loans where the future advance features are included in the “boilerplate” of the loan documents, but were never a significant concern in the loan as it was originally conceived. Five years later, the borrower and lender decide to take advantage of the mortgage's capability to secure future advances, but the title policy was set up to insure the loan as it was originally conceived. If the policy had been structured to insure future advances from the start, the borrower and lender could proceed with the advance without getting a modification of the title policy. There are two ways to adapt a policy to future advances.

1. Datedown endorsements

The date of the policy can be changed by a 'datedown' endorsement each time a disbursement is made. The original policy should be prepared for datedowns with an ALTA 32 series endorsement or a 'pending disbursement' provision that announces that the date of the policy will be advanced. A typical 'pending disbursement' exception reads:

> Pending disbursement of the full proceeds of the loan secured by the mortgage (deed of trust) set forth under Schedule A, this Policy insures only to the extent of the amount actually disbursed but increases as each disbursement is made in good faith and without knowledge of any defects in, or objections to, the title, up to the face amount of the policy. At the time of each disbursement of the proceeds of the loan, the title must be continued down to such time for possible liens or objections intervening between the Date of Policy and the date of such disbursement.

This method is practical only in cases where there will be sufficient notice before each disbursement to schedule the supplemental examination (but it is usually necessary for construction loans in states where mechanics' liens can take priority over the construction loan).

Some lenders object to a "pending disbursements" exception in Schedule B of a policy insuring a construction loan. However, as we have seen, a policy without any provision for the construction advances will not cover them. A typical notice revolving credit endorsement takes exception to the lender's actual knowledge of liens intervening between the recording of the mortgage and the future advance. Construction lenders know that contractors, materialmen and laborers are providing services, material and labor on a project, so, if the local law grants them an inchoate lien for payment, the revolving credit endorsement does not protect the construction advances. The procedures established in a "pending disbursements" exception may be cumbersome, but they protect the lender. *See, Lincoln Federal Savings and Loan Assoc. v. Platt Homes, Inc*., 185 N.J. Super 457, 449 A.2d 553 (1982).

You don't need a pending disbursements provision in your policy as a condition for bringing the date forward. A title insurer can agree to bring the policy date forward in most states, but it may charge a premium if it did not initially agree to datedown endorsements in the policy with a pending disbursements provision. If you plan on policy updates, it makes sense to set a procedure and the cost for it at the outset.

2. Future advance or revolving credit endorsements

Until 2003, the ALTA had no endorsement for future advances, so the industry used CLTA endorsements or proprietary endorsements instead. There were so many forms that it would overwhelm us to consider all of them. Future advance endorsements don't bring the transaction into compliance with the policy as a datedown does. Instead they add coverage to the policy so it will expressly insure the enforceability, validity and priority of the lien of the insured mortgage as to future advances, with exceptions for real estate taxes, bankruptcy, tax liens, etc.

f. <u>The ALTA 14.0 Future Advance – Priority Endorsement</u>

The ALTA 14 is designed for use in states that have future advance statutes giving *optional advances* either:

i. the same priority as obligatory advances or

ii. priority as of the date the mortgage was filed.

The statute must not include exceptions where the lender has received actual or written notice of any form of lien. The ALTA 14 begins by overriding Exclusion 3(d). It adds coverage whose absence makes a bare policy inappropriate for insuring mortgages that are intended to secure advances.

Section 1 defines what an advance is and ties the endorsement to the note or loan agreement. The definition does not distinguish between obligatory and optional advances because it was intended to cover both equally. It expressly includes protective advances. With the endorsement, the insured is given the freedom to make a protective advance without concern that the policy protections for protective advances are inadequate.

Section 2 of the endorsement gives the basic coverages against loss caused by the unenforceability, invalidity or loss of priority of the lien of the insured mortgage as it secures advances. On the day before the endorsements were adopted, a comment raised the concern that the original language of paragraph 2(b) might not protect a lender if a competing creditor was given equal priority to the advance, although it was clear that the lender was protected if it lost priority to the competing creditor. The provision was changed so it should protect against loss caused by 'equal priority' as well as 'lost priority.'

Section 2 also insures that the lender can re-advance funds and the lien will not fail if the outstanding balance of the loan equals zero. Section 3 gives the lender ALTA 6 variable rate mortgage coverage in addition to future advance coverage.

Section 4 contains the exceptions from coverage for advances made after the borrower's bankruptcy, loss of priority to real estate taxes and assessments, federal tax liens; environmental liens or usury. It has an optional exception for mechanic's liens if the lender fails to achieve statutory priority over unfiled liens.

The ALTA 14 should not be used in states that impose a loss of priority if the lender has actual knowledge of a competing lien even if lender's counsel argues that the advances are 'obligatory' because only letter of credit advances are obligatory if the borrower is in default when the advance is made. A title insurer cannot determine if the borrower will be in compliance at the time of an advance simply by reading the loan agreement.

g. <u>The ALTA 14.1 Future Advance – Knowledge Endorsement</u>

The ALTA 14.1 has all of the provisions in the ALTA 14, but adds paragraph 4(d) excluding coverage if the insured had actual knowledge of an intervening lien. Let's take a closer look at paragraph 4(d):

> 4. This endorsement does not insure against loss or damage (and the Company will not pay costs, attorneys' fees or expenses) resulting from: . . .
>
> d. The loss of priority of any Advance made after the insured has knowledge of the existence of liens, encumbrances or other matters affecting the land intervening between the Date of Policy and the Advance, as to the intervening lien, encumbrance or other matter.

The ALTA 14.1 was designed for states that have "knowledge" priority rules. If a lender argues that it should have full priority coverage because the loan agreement makes advances

'obligatory', your title insurer can add a second sentence to paragraph 4(d) to the effect that "Paragraph 4(d) does not apply if the advance is obligatory." By adding that sentence, the policy does not insure that the advance is obligatory, but if a court determines that it was obligatory, the endorsement will then insure that it had priority.

h. The ALTA 14.2 Future Advance – Letter of Credit Endorsement

The last endorsement, the ALTA 14.2 should be used where the mortgage secures a reimbursement obligation for a letter of credit or surety bond. With the ALTA 14 the distinction between obligatory and optional advances made no difference. With the ALTA 14.1, optional advances are subject to notice of an intervening lien. The ALTA 14.2 insures 'advances' that are given special protection in bankruptcy and against federal tax liens.

This endorsement was adopted without the ALTA 6 coverage because it was not considered necessary for letters of credit. Eliminating the ALTA 6 coverage puts the endorsement exceptions in Section 3 instead of 4, and it only has exceptions for real estate taxes and environmental liens. There is no exception for advances made after the borrower's bankruptcy or loss of priority to a federal tax lien created under 26 U. S. C. § 6321, as you would find in the ALTA 14 and 14.1. There is an optional exception for mechanic's liens for use if the mortgage did not achieve statutory priority over the inchoate rights of providers of services labor or materials.

As a result of the decision in *In re Mayan Networks*, 306 B.R. 295 (9th Cir, BAP 2004), in 2009 the ALTA Forms Committee added an exception for:

> "Limitations, if any, imposed under the Bankruptcy Code on the amount that may be recovered from the mortgagor's estate."

I think the exception is unnecessary. *Mayan Networks* required disgorgement by the Debtor's landlord as holder of the letter of credit back to the bankruptcy estate of an amount recovered by presenting the letter of credit to its issuer, Silicon Valley Bank. The letter of credit was required by the landlord as part of the security deposit, and Silicon Valley Bank required Mayan Networks to post a deposit in the full amount of the letter of credit as security for its repayment. If the bank had required real estate collateral instead of cash, it would have been the insured under the ALTA 14.2-06. The decision did not affect the bank at all, which wasn't even a party to the litigation. The bank kept the deposit after paying on the letter of credit. The landlord was required to account for the amount drawn as a setoff to its claims after the trustee for Mayan Networks rejected the lease.

i. The ALTA 14.3 Future Advance – Reverse Mortgage Endorsement

On June 17, 2006, the Forms Committee passed a reverse mortgage endorsement to be added to the ALTA 14 series as the ALTA 14.3. It is designed to insure residential reverse mortgages that fall under the Fannie Mae and Freddie Mac reverse mortgage programs. This is really a residential coverage.

11. Non-Imputation

ALTA 15-06 (Full Equity Transfer),
ALTA 15.1-06 (Additional Insured) and
ALTA 15.2-06 (Partial Equity Transfer)

a. Imputation of Knowledge

We have been asked to include some form of non-imputation coverage in many of the policies we issue in larger commercial transactions. Purchasers of partnership interests, joint venture interests, memberships in limited liability companies or shares in a corporation seek to shift the risk to the title insurer that notice or knowledge of existing or departing partners, venturers, members or shareholders might affect the title (and reduce the value) of real property owned by the entity. These purchasers fear that the notice or knowledge of the unrecorded matter might be imposed on them by imputation.

The rules for imputation of knowledge are found in agency law, although we frequently think of them in the context of corporation or partnership law. The general rule is that a principal is bound by the knowledge of its agent. So a principal-agency relationship must exist between the parties before knowledge of one (the agent) can be imputed to the other (the principal). Both the 1914 and 1997 Uniform Partnership Acts provide that notice to a partner (the agent) operates as notice to the partnership (the principal).[17] Corporations and banks are bound by the knowledge of or notice to their officers, agents and employees.[18] Notice is crucial in real estate transactions, because, in most states, a purchaser without actual or constructive notice of a prior conveyance or encumbrance on title is protected against the prior matter.

b. Recording Acts

When a party in interest conveys an interest in property by deed, mortgage or deed of trust, recording the document to another party in the United States, the recording acts of the state where the property lies will govern which of competing interests will prevail. In all states, *a*

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[17] UPA (1914) § 12:

Partnership Charged with Knowledge of or Notice to Partner

Notice to any partner of any matter relating to partnership affairs, and the knowledge of the partner acting in the particular matter, acquired while a partner or then present to his mind, and the knowledge of any other partner who reasonably could and should have communicated it to the acting partner, operate as notice to or knowledge of the partnership, except in the case of a fraud on the partnership committed by or with the consent of that partner.

RUPA (1997) § 102(f):

Knowledge and Notice …

(f) A partner's knowledge, notice or receipt of notification of a fact relating to the partnership is effective immediately as knowledge by, notice to, or receipt of notification by the partnership, except in the case of a fraud on the partnership committed by or with the consent of that partner.

[18] *See,* 10 AM. JUR. 2d, *Banks* §163; 18B AM. JUR. 2d *Corporations* § 1671; and 58 AM. JUR. 2d *Notice.*

recorded instrument creating an interest in a property *is constructive notice* of the interest, and any subsequent purchaser or encumbrancer takes subject to the recorded interest. Constructive notice means a purchaser is charged with notice of the recorded instruments, whether or not the purchaser orders a title examination to discover those recorded interests. Title insurers manage the risk of constructive notice of outstanding interests with an examination of title to reveal the interests of record.

However, where there is an *unrecorded interest* outstanding when the property is either conveyed or encumbered, one of three rules may be applied to determine priority of the competing interests, depending on the recording act of the state where the property is located. Of the three distinct types of recording acts in effect among the states, the two most common, Notice and Race-Notice type acts, require a purchaser to have no notice, either actual or constructive, of prior matters to establish priority. The three types of recording acts are:[19]

i. "Notice" type acts

Under the notice type act, found in most states, an unrecorded instrument is invalid as against a subsequent purchaser without notice, whether or not the subsequent purchaser records before the first purchaser.[20] If Jones takes an interest in real estate, but has no constructive or actual notice of Brown's prior unrecorded interest, Jones will take free of Brown's interest. Even if Brown records *before* Jones records the instrument creating his interest (but *after* Jones' interest is created), Brown's interest will be subject to Jones' interest.

ii. "Race-notice" type acts

The race-notice type act contains the same provisions except that if the subsequent purchaser records before the earlier purchaser records and the subsequent purchaser takes without actual knowledge of the earlier conveyance, the subsequent purchaser has priority.[21] If Jones takes an interest in real estate, but has no constructive or actual notice of Brown's prior unrecorded interest, Jones can take free of Brown's interest if Jones records *before* Brown. If Brown records *before* Jones records the instrument creating his interest (but *after* Jones' interest is created), Jones' interest will be subject to Brown's interest.

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[19] These definitions are from Sweat, *Race, Race-Notice and Notice Statutes: The American Recording System*, PROBATE AND PROPERTY, May/June 1989 p.27. This excellent article also contains a list of the states identifying the type of recording act and its citation for each state.

[20] Alabama, Arizona, Arkansas [other than mortgages], Connecticut, Florida, Illinois, Iowa, Kansas, Kentucky, Maine, Massachusetts, Missouri, New Mexico, Oklahoma, Rhode Island, South Carolina, Tennessee, Texas, Vermont, Virginia and West Virginia. Derived from Sweat, *supra*, p.31.

[21] Alaska, California, Colorado, District of Columbia, Georgia, Hawaii, Idaho, Indiana, Maryland, Michigan, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Hampshire [Sweat lists N.H. REV. STAT. ANN. §477:3-a(1983) as a Notice statute, but the decision in *Amoskeag Bank v. Chagnon*, 572 A.2d 1153 (N.H. 1990) interprets it as a Race-Notice Act], New Jersey, New York, North Dakota, Ohio, Oregon, Pennsylvania [other than mortgages], South Dakota, Utah, Washington, Wisconsin and Wyoming. Derived from Sweat, *supra*, p.31, except as noted.

iii. "Race" type acts

The race acts place a premium on the "race" to the courthouse. The subsequent purchaser must record before the earlier purchaser, but is protected even though aware of the earlier conveyance.[22] If Jones takes an interest in real estate, it won't matter if he has actual notice of Brown's prior unrecorded interest. Jones can take free of Brown's interest if Jones records *before* Brown. If Brown records *before* Jones records the instrument creating his interest (but *after* Jones' interest is created), Jones' interest will be subject to Brown's interest.

c. Exclusion 3b and Imputed Knowledge

The ALTA policies are designed to protect the lien of a real estate interest with a "notice" standard, giving the title insurer a defense against policy liability if the policyholder knew of the unrecorded matter that caused the loss at the time of closing, but failed to disclose it to the insurer. This limitation on coverage is contained in Section 3b of the Exclusions from Coverage. Exclusion 3 also cancels coverage for acts of the insured, incidents allowed by the insured and incidents resulting in loss or damage that would not have been endured if the insured had paid value for the insured mortgage. Exclusion 3 provides:

> The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorney's fees or expenses which arise by reason of: ...
>
> 3. Defects, liens, encumbrances, adverse claims or other matters:
>
> (a) created, suffered, assumed or agreed to by the insured claimant;
>
> (b) 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;
>
> (c) resulting in no loss to the insured claimant;
>
> (d) attaching to or created subsequent to Date of Policy(except to the extent that this policy insures the priority of the lien of the insured mortgage over statutory lien for services, labor or material); or
>
> (e) resulting in loss or damage which would not have been sustained if the insured claimant had paid value for the insured mortgage.

In the beginning, the non-imputation risk focused solely on Exclusion 3(b), but recently investors have broadened the focus to include concerns about Exclusions 3(a) and 3(e) as well. It could be argued that a title insurer could not apply the acts of the others, incidents allowed by others and incidents resulting in loss or damage that would not have been endured if others had paid value for the insured mortgage because the exclusion only applies to acts and knowledge of the 'insured claimant.' The act or knowledge of anyone else should not affect the coverage. However, the argument is still enough of a stretch to make ordering a non-imputation endorsement a prudent decision.

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[22] Arkansas [mortgages only], Delaware, Louisiana, North Carolina, and Pennsylvania [mortgages only]. Derived from Sweat, *supra*, p.31.

d. Managing the Non-Imputation Risk

A title insurer is without a means of managing the risk of unrecorded documents, the existence of which are known to the insured, so it protects itself with Exclusion 3(b) if no non-imputation coverage is requested. This position is consistent with the stance of other insurance lines. Even casualty lines of insurance take exception to such risks, e.g., life and health insurers do not accept liability for pre-existing health conditions of the insured that are not communicated to the insurer on the application.

Can the title insurer manage the risk of a loss due to an unrecorded matter not known to the insured (or an incoming owner of an interest in an insured entity) when notice of it is imputed to the insured or insured entity? Protection against such a risk appears similar to other protections against "hidden risks" afforded by a title policy. The insured has clean hands in such a case, unless a thorough "due diligence" investigation would reveal the unrecorded transfer or encumbrance. Under limited circumstances, title companies began to underwrite these risks.

At the beginning of the 1980's, certain life insurance companies began to invest in partnerships or joint ventures holding or developing real property. In most cases, the insurance company would convert a construction loan into an equity position after the developer completed construction and began the rent-up phase. By purchasing a partner's or joint venturer's share, there was no conveyance of title to the real estate. Thus, the life insurer's interest was not protected by the recording acts, so any unrecorded matter affecting title would be unaffected. By purchasing a share in the partnership or joint venture, the life insurance company also accepted its developer partner as the agent of the venture, so the law imputes to it any knowledge of or notice given to the developer.

The life insurers were not satisfied with this risk of loss through imputation, so they demanded that the partnership's title policy contain affirmative coverage against the imposition of Exclusion 3(b) as a defense to a claim under the policy by the partnership. Title insurers agreed to give this coverage limited to knowledge of the owner or developer at the Date of Policy, if satisfied that the risk of loss was eliminated by:

i. receipt of a written description of the complete structure of the transaction,

ii. receipt and review of satisfactory current financial statements of any party or entity required as indemnitor (*i.e.*, all withdrawing partners, or all existing and remaining partners in a partnership, or current and former officers and directors of the acquired corporation),

iii. receipt of satisfactory affidavits from individuals, partners or partnerships, officers, and directors of the acquired corporation. Copies of specimen affidavits are included in Appendix B together with copies of basic non-imputation endorsements.

iv. receipt of satisfactory indemnity bonds from individuals, partners or partnerships, officers, and directors of the acquired corporation, and

v. receipt of a written request for the non-imputation endorsement.

This coverage applies to situations where a party buys an interest in an insured property, but acquires the interest through the purchase of shares of stock, a partnership share or

membership in an LLC. Virtually all of the circumstances requiring non-imputation coverages involve these ownership interests. Lenders rarely need non-imputation coverage.

e. Automatic Non-Imputation for Mortgage Assignees

Most transfers of loan indebtedness are made by assignment. The loan policy protects assignees of the indebtedness in its definition of the term "Insured" in Section 1(e) of the Conditions (*see*, footnote 10 on page 23). Thus an assignee for value should not be troubled by potential defenses of the title insurer based upon matters known to the original named insured in the policy if it has no notice of that matter.

f. Non-Imputation Endorsements

For years title insurers have issued proprietary non-imputation endorsements. Most have been limited to protecting a new owner from the impact of Exclusion 3(b) only. The ALTA Forms Committee reported three non-imputation endorsements to the ALTA. They broaden the coverage to protect the party from the operation of Exclusions 3(a), 3(b) and 3(e) as they apply to existing or former participants in the entity owning the insured land.

I have one important caution about non-imputation endorsements. A prudent title insurer must manage the risk that the selling party has not created any off-record matter that might emerge at a later time to cause a loss. It does this first by limiting the coverage to matters that occurred before the Date of Policy. Limiting the risk to past events permits the title insurer to manage the risk by requiring the existing party to affirm that there is no off record matter that might affect title. Although limiting the coverage to the past is necessary, as we shall see with the ALTA 15.1, it might create a coverage gap if you aren't paying attention to the details.

g. The ALTA 15 Non-Imputation – Full Equity Transfer Endorsement

The ALTA 15 was designed for situations where the entire ownership of the entity owning the land has changed hands. It protects the incoming partners against defenses that the title insurer may have had against the outgoing owners of the landholding entity under Exclusions 3(a), 3(b) or 3(e). It is intended for a new policy issued to protect the incoming owners.

h. The ALTA 15.1 Non-Imputation - Additional Insured-06 Endorsement

The ALTA 15.1 is similar to the ALTA 15 but is formatted for situations where the existing entity is the named insured in the policy and landholder to protect an incoming partner, member, or shareholder.

I think this endorsement continues a flaw that began with the earliest non-imputation endorsements. It does not bring the Date of Policy forward, so it either misses the period of greatest risk to the additional insured, or, if it is construed as insuring the period from the Date of Policy to the date of the endorsement, it may lull an issuing office or agent into issuing it without conducting a fresh title rundown. I would caution its use only after careful examination and amendment so its meaning is clear.

i. The ALTA 15.2-06 Non-Imputation – Partial Equity Transfer Endorsement

Finally, the ALTA 15.2 is also similar to the ALTA 15, but is formatted for an incoming partner, member, or shareholder, as the named insured in its own policy, where the landholder is a partnership, limited liability company or corporation.

12. Mezzanine Financing

ALTA 16-06 (Mezzanine Financing)

a. Structured Financings

Many commercial borrowers divide their borrowings into tiers or 'tranches' to optimize the cost of borrowing. For a very simple illustration, let's imagine that ABC, LLC seeks to borrow $100,000,000 and discovered that it would cost LIBOR + 3% to borrow the full amount in one slug. However, if it structures the financing into tiers, having two levels of debt secured by mortgages, one level secured by a pledge of the memberships in the LLC, and the last an unsecured level as shown in this diagram, the effective interest rate in this simple example is LIBOR + 2.7%

Total Loan Facility	Tiers
Total Loan Facility $100,000,000 To ABC, LLC	Tier 1 Senior Real Estate Financing Secured by a 1st Mortgage $20,000,000 Rate: LIBOR + 1
	Tier 2 Junior Real Estate Financing Secured by a 2nd Mortgage $30,000,000 Rate: LIBOR + 2
	Tier 3 Mezzanine Financing Secured by pledge of ABC, LLC memberships $30,000,000 Rate: LIBOR + 3
	Tier 4 "First Loss Piece" Financing Unsecured $20,000,000 Rate: LIBOR + 5

Until recently, title insurers limited their participation in these structured transactions to those top two tiers that were secured by mortgages on the real estate. The bottom tiers were not a part of the title insurance market. However, those subordinate lenders recognized the critical role that real estate plays in so many of these transactions, and if there is a major title loss, it may exceed the title insurer's liability on the two loan policies. If the lenders in the bottom two tiers, the mezzanine and the unsecured 'first loss piece[23]' financing, can require the borrower to buy an owner's policy, and capture the title insurer's liability to it, they will gain some protection against that title risk.

In mezzanine financing, it's not the landowner that transfers a security interest in the collateral to the Mezzanine Lender. The landowner owns the land. Its owners pledge their

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[23] Its unfortunate that the endorsement allowing a claim before requiring foreclosure on all the collateral in a multi-site mortgage transaction has also been named "first loss." The different usages for this term in a transaction may cause some confusion.

interests in the landowner itself for the Mezzanine Lender's security. Thus the pledging entities may be shareholders, partners or members of the landholding entity, or even shareholders, partners or members of an entity that owns the entity that owns the land. Although some earlier mezzanine financing endorsements required the Mezzanine Lender to take title to the pledged ownership interests in the landowner as a condition to its right to payment for a loss, there is no real rationale for making that requirement.

b. Insuring a Mezzanine Financing

The mezzanine lender usually has a security interest in the ownership interests of the entity that holds title to the land. It can seek UCC insurance for this security interest, and most title insurers can either issue or obtain the UCC policy for it. However, the UCC policy is another policy to buy, and it is an additional expense for a junior loan. There is a title insurance solution that has become popular in recent years.

If a mezzanine lender or first loss piece lender has no ownership interest, or mortgage, does it have any insurable interest in land at all? Well, we can't insure its interest with a loan title insurance policy because there is no lien to insure. These lenders will not have an ownership interest in the land unless the mezzanine lender realizes upon its pledges of the ownership interests, and even then the interest is indirect, so it appears that these lenders have no traditional insurable interest in the land or in a mortgage on the land.

However, these lenders have recently sought title insurance coverage in the owner's policy with a 'loss payable' provision similar to those found in a typical property/casualty homeowner's policy. The borrower does have an insurable interest because it is the landowner. If it gets an owner's policy, the mezzanine lender can bargain for the right to receive any title insurance proceeds that the borrower might receive from the title insurer.

So a lender that is not secured by a mortgage lien on the land can nevertheless find some protection from title risks to the borrower in a Mezzanine Financing Endorsement. New York had a Mezzanine Financing Endorsement that served as a model for the ALTA 16 Mezzanine Financing Endorsement.

The New York endorsement limits its liability to a lender that has taken possession of ownership interests in the entity holding title to the land. The ALTA endorsement rejects that restriction, so although it is named a Mezzanine Financing Endorsement, it will serve an unsecured lender, as well. Perhaps the endorsement is misnamed, but it is convenient to continue a name recognized by our customers and it gives the loss payable beneficiary a convenient name, Mezzanine Lender.

The insured in the Owner's Policy must be the landowner, because it has the only insurable interest. To assign its rights to receive payments from the title insurer in the 'loss payable' provision, the landowner must also execute the endorsement. Consequently, the process of executing this endorsement is more cumbersome than our ordinary experience with endorsements. The Mezzanine Financing Endorsement can be issued with a new owner's policy when the loan is closed, or issued to amend an existing owner's policy held by the borrower.

In addition to recognizing the Mezzanine Lender as a loss payee, the title insurer agrees in paragraph 5 of the endorsement that Exclusions 3(a), 3(b) and 3(e) will not be applied against the borrower to defeat a recovery by the Mezzanine Lender

The ALTA 16-06 removes the requirement for the insured's consent before a Mezzanine Lender can participate in claims negotiations. The Forms Committee decided that a Mezzanine Lender has too much at stake to be denied a place at the table, as it is in the New York endorsement.

The Mezzanine Lender must consent to any later change in the policy coverage. Paragraph 8 of the revised draft includes a 'standstill' provision with respect to the title insurer's right of subrogation against the insured, the borrower or a guarantor of the Mezzanine Loan.

Paragraph 6 is a "Fairway" provision protecting the Mezzanine Lender in case it acquires the ownership interests pledged to it. It may be the only '*Fairway*' provision ever to be adopted by the ALTA. That's not because the ALTA wants to preserve the *Fairway* issue, but because it never applied to ALTA policies in the first place, and the new policy revisions should put this issue to rest, at last.

13. Access and Entry

ALTA 17-06 (Direct Access),
ALTA 17.1-06 (Indirect Access) and
ALTA 17.2-06 (Utility Access)

a. Access in the Policy Forms

Both the ALTA owner's and loan policies insure access to the Land. It is Covered Risk 4, and it states, succinctly that the Company insures against loss or damage cause by a, "Lack of a right of access to the land."

Access should be a simple concept. To insure 'access' to the land, a title insurer must only show that the insured can go to and from at least one public street and some point on the boundary to the land without the interference of the rights of another party. An owner can establish a right to access if the land abuts a public road, or if there is an appurtenant easement of right of way or a private road to the land.

To illustrate, imagine two lots numbered 1 & 2. At some time in the past (before subdivision control laws), an owner of Lot 2 sold its road frontage to the owner of Lot 1. Lot 1 has apparent access to the street, but Lot 2 is "landlocked" by Lot 1 and the other surrounding lots. It has no access to the street because the rights of the owner of Lot 1 block it.

Lot 2 does not have insurable access in this illustration, so a title insurer will take an express exception to access in its title insurance policy to override insuring provision 4. However, if a right of way easement to the street had been reserved for Lot 2 when the frontage was sold, it would still have insurable access. It would also have insurable access if the title to both lots were vested in one owner.

a. Insurable Access in Court Decisions

The insured has access even if the way between the street and the boundary is long and dangerous. *Gates v. Chicago Title Insurance Company*, 813 S.W.2d 10 (Mo. App. 1991). A 2½ foot barrier in a parking lot might make it impractical to travel from one lot to another, but it is not a lack of a right of access. *Magna Enterprises, Inc. v. Fidelity National Title Insurance Company*, 104 Cal. App.4th 122, 127 Cal. Rptr. 681 (2002). These cases apply the conventional standard - if the insured has the right to get to its land, it has access.

The opinions in both *Gates* and *Magna Enterprises* distinguished the earlier decision in *Marriott Financial Services, Inc. v. Capitol Funds, Inc.,* 288 N.C. 122, 217 S.E.2d 551 (1975). Marriott Financial bought a parcel of land, from Capitol Funds, along Wake Forest Road in Raleigh for development of a Roy Rogers fast food restaurant. Its purchase was insured by Lawyers Title. The City of Raleigh denied Marriott's application for driveway permits. The lot's frontage along Wake Forest Road was within 150 feet of a bridge over Crabtree Creek. The city would not allow driveway permits closer than 200 feet to the bridge because the road had such heavy traffic. Earlier, Capitol sold an adjacent parcel to an automobile dealer, and the city placed a notation on the dealership lot's plat that the parcel later sold to Marriott was "not an approved lot." Marriott sued capitol for rescission, or alternatively for recovery under its title insurance policy

The Supreme Court of North Carolina reversed an order dismissing an access claim against Lawyers Title because it found the insured had 'pedestrian' access only to Wake Forest Road. Marriott's access was described as 'pedestrian only' because the city had refused to grant it the driveway permit to the road. The *Marriott* court confused a permit for a driveway with access, and applied a right of way classification to an access right. It ignored the terms in paragraph 4 of the Lawyers Title policy by holding that mere 'pedestrian' access was not 'reasonable' access when the insured sought 'vehicular' access for development of the fast food restaurant. I suspect that the Supreme Court thought that the city's notation on the auto dealer's plat that the adjacent parcel later sold to Marriott was "not an approved lot" was warning enough to the title insurer. It could have ruled that the title insurer had a duty under the policy to disclose the limitation stated on the auto dealer's plat to reach the same outcome without confusing the issues.

The *Marriott* decision is unrealistic because it suggests that the policy insured 'reasonable' access for Marriott's planned use, even though land was undeveloped. Of course, access has nothing to do with permits to build or use driveways and parking areas inside the boundaries of the land. The process of securing development permits often requires some concessions. Changing the facts slightly, if Marriott's optimal design had included two curb cuts on Wake Forest Road and two on an adjacent side street that empties onto Wake Forest, would it have had a title claim if Raleigh had limited it to one curb cut on Wake Forest and one on the side street, if that plan would still work for the business? Title insurers have no means for managing the risk of insuring the outcome of a future development permit process. Insuring the existing permitting may seem reasonable for most cases, but it would not have helped Marriott.

It would seem that the *Marriott* decision, having misstated the concept of access, and suffered criticism in subsequent access cases, should simply melt away into obscurity. Unfortunately, the court coined the terms "pedestrian and vehicular access." Afterwards, title

insurers agreed to those terms in affirmative access coverage endorsements. The ALTA followed suit by including them in the Homeowner's and Expanded Coverage Residential Policies.

c. "Pedestrian and Vehicular Access"

The law recognizes pedestrian ways (foot paths) and vehicular ways (streets and highways), so a right of way can be described as a pedestrian or vehicular way. Access may involve either kind of way or both, but the *Marriott* case is the only decision that I can find that transfers the concept of a "pedestrian and vehicular way" to access. The Marriott interpretation has been rejected in subsequent cases, but the term lingers on, so what does it mean? If it means anything, it must be that the public street or way to a public street needed as an element of access must allow both foot and vehicular traffic.

Others have suggested that it means that the owner can drive up to and on the insured land. That means there is no 'pedestrian and vehicular access' to many urban residential and commercial properties built on lots on city blocks because the sidewalk keeps a vehicle away. That rules out a large set of real estate from coverage eligibility. It also raises some other questions. If the boundary between the land and the street is the edge of the actual roadbed, but there are no curb cuts, does the owner have 'pedestrian and vehicular access?' What if the frontage is a 'no parking' zone?

If we return to *Gates*, the policyholder asserted a claim after being denied access to his land over an "east road." Chicago Title said the lot had access by a "west road" as well. However, Gates testified that the "west road" was a "goat path." He once traveled the 'west road' in a four-wheel drive vehicle with the 'passengers' walking alongside "watching that we didn't fall over the side of the mountain." Perhaps a mountain bike would easily make that journey. Mountain bikes are vehicles. What if the road easily accommodates automobiles, but is too narrow for heavy earth moving trucks? Does the insured have reasonable access? Where do we now draw the lines? 'Pedestrian and vehicular access' may confuse a concept that was reasonably settled before.

d. Utility Access

Many lists of requested endorsements include a "utility facility endorsement" or a "utility availability endorsement." Until 2008, these were not standard endorsements, and often they were drafted by people outside the industry who were taking a stab at the coverage. Recognizing that some discipline was necessary, the ALTA considered several of the endorsements in circulation to determine how to craft a title insurance coverage to meet our customer's needs. Insurance must be specific so each party understands the insurer's liability to the insured. Insuring against loss if specified services are not "available" to the Land is ambiguous.

Certainly, nobody expected the title insurer to pay all of the utility bills for the specified services during the period that the Insured occupies the Land. So, does it mean that these utilities are actually connected? Should a policyholder have a claim in a power outage because the "availability" of electrical power has been interrupted? Should the title insurer race around on the day of closing to transfer all of the utility billing accounts to the buyer? If it is a loan policy, does the insurer have this obligation if the Insured forecloses on its mortgage? No, that

doesn't make much sense either, and few customers want the title insurer to be that involved in their affairs in any event.

Are we being asked to insure that connection fees are paid? I am sure that many would like that coverage, but it has nothing to do with title. Why stop here? Why not ask for coverage against loss if any improvement on the land was not built to code with a building permit? Better yet, insurance against loss if the local jurisdiction refuses to permit development of the Land as the buyer envisions? This spins out of control so quickly. If we view the issue from a title perspective, what do we have? It is an access issue.

e. ALTA 17-06 Access and Entry Endorsement

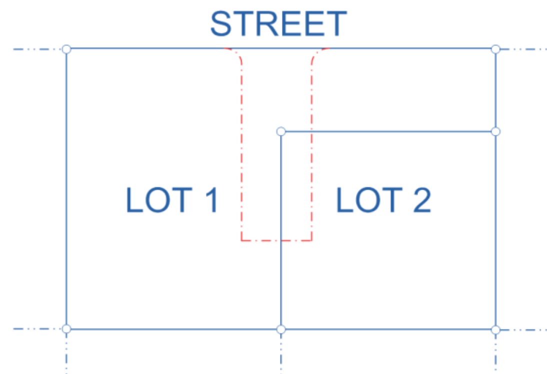
The ALTA has adopted the ALTA 17-06 Access and Entry Endorsement to insure that the land abuts a public street; the insured has actual "vehicular and pedestrian access" and has the right to use existing curb cuts or entries. The express wording of the endorsement limits the insurance to the state of facts existing at the Date of Policy, so it should not be construed as insuring against interruption or obstruction of access for a later cause like street repairs or street widening. It does not insure the policyholder's first choice for a development plan for the land, either.

f. ALTA 17.1-06 Indirect Access and Entry Endorsement

Upon considering this endorsement, the ALTA forms Committee decided that it should also propose an ALTA 17.1-06 for land not abutting a public street. It insures when the policyholder has access to the public streets over an easement. The Commercial Endorsements Subcommittee drafted the proposed ALTA 17.1 endorsement, in December 2003 and the ALTA Board of Governors swiftly adopted it just a little more than a month later on January 17, 2004.

The coverages in the ALTA 17.1 are substantially the same as in the ALTA 17, but access and entry are insured over an easement identified in the endorsement. The endorsement indemnifies the insured if it cannot use "curb cuts and entries along that portion of the street abutting the easement."

It should be easy to select the correct endorsement. The facts will dictate. Let's take our original example, and add a common driveway and easement to serve both Lots 1 & 2 (designated by the broken lines). We can use an ALTA 17 to insure access and entry for Lot 1, but an ALTA 17.1 must be used to insure access and entry for Lot 2



g. ALTA 17.2-06 Utility Access Endorsement

If the words "available" and "availability" are too vague to define this interest in real estate, "access" should do nicely. The endorsement insures against loss if there is no access for the specified services through an abutting street or an easement. Connecting to the service is the policyholder's responsibility. We can designate which services by check boxes on the endorsement, or add other services on the blank lines on the form.

☐ Water service	☐ Natural gas service	☐ Telephone service
☐ Electrical power service	☐ Sanitary sewer	☐ Storm water drainage
☐ ________________	☐ ________________	☐ ________________

The endorsement actually goes farther than most "utility facility" or "utility availability" endorsements because it expressly insures that there are no gaps between the boundary of the land and the right of way, or gaps in the right of way itself, or a termination of the right of way. It's not unheard of to receive a request to search the title to all utility right of way back to the water plant, power substation, gas plant, etc. That coverage against gaps in the right of way even addresses that issue.

14. Tax Parcel

ALTA 18-06 (Single Tax Parcel) and
ALTA 18.1-06 (Multiple Tax Parcel)

a. Tax Parcel Issues

A buyer of a single lot or parcel has concerns about how that parcel is taxed by the local jurisdiction. If taxes are unpaid, all of the property in the tax parcel can be sold so the taxing jurisdiction can recover the unpaid taxes, penalties, interest and expenses of sale. A landowner controls the payment of taxes for land it owns if the 'tax parcel' is congruent with land described in the transaction. If not, the landowner may be paying somebody else's taxes as well, or might lose all or a portion of its land if the property is sold to satisfy unpaid taxes for a larger tax parcel. It's important to be sure that no mistakes were made in describing the tax parcel for the land, and in properly designating the landowner, or its mortgagee, to receive the tax bills.

The owner of a single lot wants insurance against loss caused by the tax parcel including more land than is described in the title insurance policy because the taxing jurisdiction did not post the subdivision of the insured land from the larger parcel. It also wants protection against the possibility that the insured land includes land in two tax parcels. If the land is dependent on another parcel for access, parking, etc., the owner may want assurance that a tax sale of that easement parcel will not unseat its rights in that parcel.

b. ALTA 18-06 Single Tax Parcel Endorsement

The ALTA 18-06 is a conventional tax parcel endorsement that insures against loss if the tax parcel includes more land than is described in Schedule A, or does not include all of the land described in Schedule A. If there are no easements critical to access or any other purpose to the land, the ALTA 18 is a suitable choice.

c. ALTA 18.1-06 Multiple Tax Parcel Endorsement

The ALTA 18.1-06 adds indemnification against loss where "the easements, if any, described in Schedule A being cut off or disturbed by the non-payment of real estate taxes assessed against the servient estate." A comment indicated some concern about the affect of an assessment lien as well as real estate taxes. The Forms Committee added assessments imposed

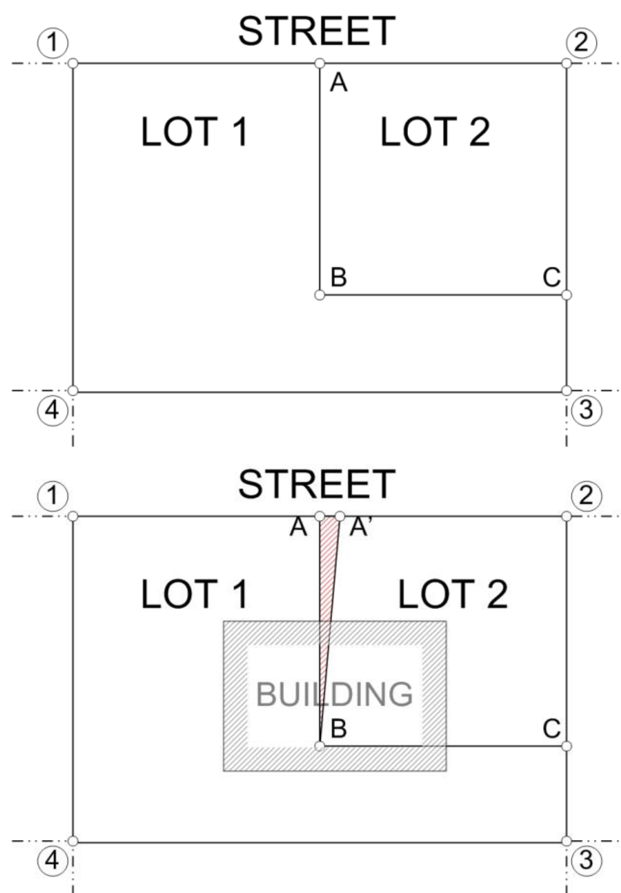
by a governmental authority to the coverage. It is designed for properties, like shopping center outlots, that depend on easement rights for vital service like access and entry. .

15. Contiguity

ALTA 19-06 (Multiple Parcels) and ALTA 19.1-06 (Single Parcel)

I see a proper 'contiguity' coverage as eliminating *all* outside interests that may come between two parcels. However, simply stating that two parcels are 'contiguous' doesn't eliminate the possibility that the rights of another may separate the two parcels at some point.

a. Assemblages



Let's imagine a very simple assemblage of two parcels of real estate into one larger parcel that the buyer intends to use as a single large parcel. In the diagram, Lots 1 & 2 have been assembled into a single parcel defined by corners 1, 2, 3 & 4.

The buyer expects the two lots, Lot 1 & Lot 2, to be contiguous along lines AB and BC so nobody else will have any rights to interfere with its abilities to build a structure straddling lots 1 & 2, and since both lots front on the street along line ①-②, the buyer expects no impediment to unfettered access between the lots.

That is the expectation, but let's change the facts slightly. After buying the two lots, the owner discovers a problem. The lots are contiguous along the line BC, but a gore appears along the line AB, and it widens as we get closer to the street at A. So, if a title insurer insures that Lots 1 & 2 are contiguous, can it defend on the basis that they are indeed contiguous along BC? Will it lose because the lots are *not* contiguous along AB?

Why should AB make such a difference? It is plain that Lot 1 has four other lines that are not contiguous with any other line (A-①, ①-④, ④-③ & ③-C), and Lot 2 has two such lines (A-② & ②-C). Nobody expects a contiguity endorsement to insure that any of those lines are

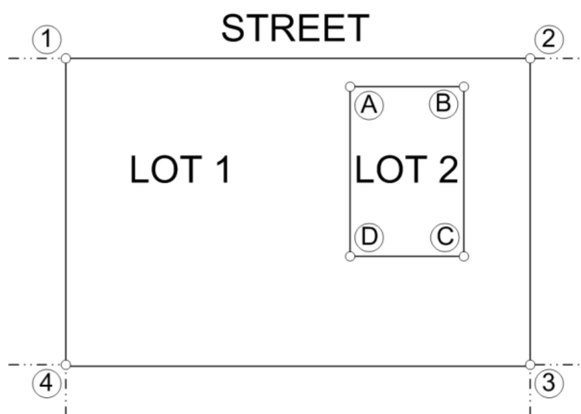
contiguous to a line in the other lot because they are so plainly not contiguous. BC makes the two lots contiguous, so isn't that enough?

I doubt if the policyholder would be satisfied with this minimal contiguity if its goal was to construct a building straddling the two assembled lots, or to have unfettered access from one to another across AB. It seems to me that our conventional contiguity coverage is ambiguous and insufficient.

b. Perimeter Descriptions

We can easily correct this problem by using a perimeter description of the assembled parcel within lines ①-②, ②-③, ③-④ & ④-①. If we use this perimeter description, we are insuring that nobody else has any rights inside that perimeter, unless we take exception to specific rights in Schedule B. This solution neatly resolves the contiguity issue, and makes any endorsement unnecessary. Unfortunately, it is not always possible to apply this tidy solution.

Often custom, practice or the title insurance customer prevents creating a new description for the assembled lots. In some other cases, the two estates may not be the same, so we can't use a new perimeter description. If Lot 1 is a fee estate, and Lot 2 is a leasehold a perimeter description will not work.



Also we might have an outlot in a shopping center, owned in fee, but the insured may want its easement rights in the center insured as well, so the policy will insure title to a fee parcel surrounded by an easement parcel.

Most shopping centers have reciprocal easement agreements or operating agreements that give the tenants rights to the common areas, including the parking lots. Those easements are crucial to fee owners of anchor outlots because the shopping center landlocks the outlot. The outlot owner may also demand insurance that the lot lines for outlot are contiguous to the adjacent lines of the center so nobody else has the right to interrupt access to the outlot. A perimeter description will not work here, because the two parcels are not being assembled in this transaction.

c. Contiguity Endorsements

I see three basic ways to construct a contiguity endorsement. Let's return to our first illustration (with no gore at AB).

First, the endorsement may insure that Lot 1 is contiguous to Lot 2. I hope the weaknesses of this approach are obvious from the previous discussion.

Second, the endorsement could insure that nobody else has any rights between Lot 1 & Lot 2. I actually favor this form of coverage because it avoids vague concepts like 'contiguity' and goes to the heart of the matter. If the company insures that no other has rights between Lots 1 & 2, the coverage protects against any gore that would separate the two lots. We avoid the

problems of saying Lots 1 & 2 are contiguous to each other along lines AB and BC (if that was true).

The third approach is to insure that the lots are contiguous along specified lines. This approach avoids the ambiguity. Now this form of endorsement would specify that lines AB & BC in both lots are contiguous to one another. This is perhaps the most precise of the contiguity endorsement forms, but it is a bit clumsy, especially if the assemblage involves multiple parcels or a large number of calls between parcels. Like our first endorsement form, this form speaks of 'contiguity' and makes the reader infer that 'contiguity' eliminates the rights of anyone else to interfere with the insured's rights across the lines. After all, isn't that the insured's goal?

d. ALTA 19-06 Contiguity – Multiple Parcels Endorsement

The ALTA Forms Committee combined insuring specified lines with coverage for, "the presence of any gaps, strips or gores separating any of the contiguous boundary lines described above" for the ALTA 19-06 and 19.1-06. It's a hybrid form of coverage.

The ALTA 19 is a conventional contiguity endorsement for insuring the contiguity of two or more parcels described in Schedule A. It meets the conventional role for contiguity coverages where a number of separate lots or tracts are assembled into one larger tract.

e. ALTA 19.1-06 Contiguity – Single Parcel Endorsement

The ALTA 19.1 is designed for insuring that the land described in the policy is contiguous to adjacent land not insured by the policy. Although it may seem marginal compared to the demand for the assemblage coverage, it can be used for that shopping center outlot. In addition, it might be useful if a landowner buys adjacent land and wants insurance that the new lot is contiguous to the old lot. By using an ALTA 19.1, the buyer could insure contiguity without disturbing the title insurance for the original lot.

16. First Loss

ALTA 20-06 First Loss Endorsement

A "first loss" endorsement` is requested by lenders in some multi-property transactions to accelerate the payment of a loss under a loan policy if the value of one of the properties is diminished by a matter covered by the title insurance. Several forms of first loss coverage have been in circulation since the 1980s, but the endorsements are vague.

When the ALTA Forms Committee began exploring the value of a standard form, many legal commentators remarked that they did not know what the endorsements meant, or what they would do. Many real estate lawyers were skeptical that the ALTA Forms Committee could ever fashion a workable endorsement. Of course, it was obvious that a new standard endorsement must do at least as much as the general perception of the existing endorsements, or the new endorsement would not replace them. It has taken the Forms Committee longer to produce this endorsement than the others because the concept is both elusive and controversial.

a. The Early First Loss Endorsements.

The general perception is that first loss coverage should entitle the lender to a payment on a loss without requiring foreclosure of all of its security (subject to certain limitations). Lenders seeking first loss think it gives them the same protection in a title insurance claim as if the loan was secured by a single property, but in practice first loss coverage probably goes beyond that.

If a loan is secured by one property and that property is affected by a title defect that substantially reduces its value, the lender can declare a default, accelerate the indebtedness and foreclose (unless foreclosure is futile). It may then seek indemnity from its title insurer to the extent its security is inadequate to repay the loan, interest and costs as a result of a defect in title covered by the title insurance. The decision to foreclose and realize upon the collateral is rarely complicated by the problem of whether the borrower could survive without the property; because in most cases it can't.

In multi-property transactions, however, lenders are concerned about the consequences of potential title defects affecting just one of the properties that may cause a substantial loss of value to that property and impair the security for the loan. The lender's choice either to accelerate the indebtedness to protect itself or to allow the loan to continue to protect the borrower becomes complicated if the lender has an otherwise financially healthy borrower capable of surviving the loss of the affected property. If the lender accelerates and forecloses against all of its security to protect itself, it will destroy its borrower; if it doesn't accelerate, it may be undersecured and runs the risk that it may suffer a greater loss later. Under a loan policy of title insurance, however, such a lender has suffered no loss requiring indemnity, because: (i) the coverage will continue to protect the lender from loss as a result of the defect, in effect replacing the value lost in the property securing the loan; (ii) most loan security packages include more value in the collateral than is loaned and (iii) the other unaffected properties may adequately secure the loan.

b. The ALTA 20-06 First Loss Endorsement – Multiple Parcel Endorsement

The ALTA Forms Committee played with several concepts for this endorsement before landing on the current form. If title insurance is an indemnification line of insurance, it seems inconsistent to create a coverage that will compensate an insured when it determines its collateral has been impaired, but has not exhausted its collateral to establish a monetary loss. If the borrower and insured lender proceed with the loan after the title insurer makes a payment under the endorsement, the one of them may realize a windfall at the end of the transaction.

Liability is triggered under the endorsement when a loss insured against by the policy materially impairs the insured's security under the insured mortgage. The endorsement begins by defining "Indebtedness", "Collateral" and "Material Impairment Amount." The "Material Impairment Amount" is the difference between the value of the insured's Collateral and the value of the Indebtedness after a loss caused by a title defect lien, encumbrance or other matter. If the loss does not reduce the value of the Collateral below the value of the Indebtedness, there is no Material Impairment Amount and no liability under the endorsement. When the value of the Collateral is less than the Indebtedness because of a loss, the company is liable to pay the insured the Material Impairment Amount, not to exceed the limits of Section 8 of the Conditions.

The liability is triggered even if the insured has not accelerated the payment of the debt, pursued its remedies against any of the Collateral, whether real or personal, or pursued any remedies under guaranties, bonds or insurance policies. The title insurer agrees to a 'standstill' against remedies against the borrower until the insured lender has been paid in full. The Title insurer does reserve its rights of subrogation against the borrower or a guarantor after the insured lender has been paid, and has the right to recoup from the insured lender any money received in excess of the amount it is due.

17. Location

ALTA 22-06 (Location) and
ALTA 22.1-06 (Location and Map)

The ALTA acknowledged the pressure for a location endorsement modeled on the form of the CLTA 116.1 by passing new location endorsements on June 17, 2006. The ALTA 22-06 insures that a described improvement with an identified address is located on the land at the Date of Policy. The ALTA 22.1-06 adds coverage that a map attached to the policy correctly shows the location and dimensions of the land according to the public records.

18. Co-Insurance

ALTA 23-06 (Me, Too)

In some jurisdictions, notably, New York, transactions are frequently insured by several title insurers, ostensibly to spread risk, although reinsurance does that more efficiently from the Insured's point of view. The Co-Insurance Endorsement contemplates the 'lead' insurer as the "Issuing Co-Insurer" that will do all of the work of searching, examining and issuing the Co-Insurance Policy, and the other Co-Insurers simply issue the ALTA 23-06 to ratify the policy of the Issuing Co-Insurer. Many years ago, each Co-Insurer did its own work, but it is manifest that having several different forms of coverage on the same property causes more work for the insured who generally negotiated a single form of coverage among the Co-Iinsurers. The "Me, Too" form of endorsement was devised to relieve the Insured of the burden of negotiating separate agreements with each Co-Insurer to follow a single model, and then to review each policy to verify that they are all congruent. Of course, if there is a need for modifying the title insurance coverage after the policy has been issued, all Co-Insurers must agree to the modification, so the insured has not escaped entirely by using the endorsement. In addition, one company can't endorse the policy of another, so each company's execution of the Co-Insurance Endorsement is actually a separate, but identical policy. Finally, regulators do not permit assumption of joint and several liability among companies because that would make reserving for losses almost impossibly difficult, so the insured must make a claim against each Co-Insurer if it has suffered a covered loss.

The Issuing Co-insurer will issue the policy which will be defined as the Co-Insurance Policy in the endorsement. The Issuing Co-insurer may either enter its proportionate share of the risk, or the entire risk as the Amount of Insurance in Schedule A, but the Amount of Insurance in

Schedule A is superseded by the endorsement and its allocations. If the risk is spread by reinsurance instead of co-insurance, the Amount of Insurance would be the full amount because a reinsured company remains liable for the entire amount. The liability of the Issuing Co-Insurer, and each of the other Co-Insurers, on the other hand, is limited to their respective proportionate share as established in the endorsement, so the Amount of Insurance in Schedule A of the Co-Insurance Policy is vestigial.

Now that the ALTA facultative[24] reinsurance agreements used by the title insurance industry include "Direct Access" provisions that empower an insured to seek recovery against the reinsurers of its transaction, despite not having privity with the reinsurers, reinsurance is much cleaner than co-insurance. All reinsurers must accept the issued policy, and a claim against the reinsured company is a claim against all. Making a claim under the "Direct Access" provision is very rare, and only necessary if the reinsured company can't respond to the claim, but it is a necessary backup.

19. Doing Business

ALTA 24-06 (Doing Business)

All ALTA Loan Policies since, at least 1970, have included an exclusion to a state's doing business laws as Exclusion 4. Exclusion 4 in the 2006 ALTA Loan Policy says:

> 4. Unenforceability of the lien of the Insured Mortgage because of the inability or failure of an Insured to comply with applicable doing business laws of the state where the Land is situated.

If there is no exclusion for the insured loan in the state doing business law, this exclusion protects the insured from claims that a mortgage is unenforceable if the lender fails to comply with the law. The exclusion is a carve out from Covered Risk 9 of the 2006 ALTA Loan Policy that insures against loss caused by the invalidity or unenforceability of the lien of the Insured Mortgage.

However, most states do not require a lender to comply with their doing business laws if the lender only makes a mortgage loan on land located in the state without actually conducting business operations in the state. If there is an exemption, Lender's counsel may ask the title insurer to override Exclusion 4 with a "doing business" endorsement. For Example, Virginia

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[24] "Facultative reinsurance" is reinsurance negotiated and purchased on individual transactions. If a title insurer is required or decides to reinsure a risk, it will use a facultative reinsurance agreement to make its arrangement with its reinsurers. Reinsurers for title insurance in the United States must be qualified as title insurance companies, so the reinsurers on most transactions are usually the large national title insurance companies. Some small regional title insurers may not have the capital that will allow them to insure all but the smallest risk because of state statutory retention formulas. To increase their capacity, they can enter into a "treaty" with a larger insured that will cover all risks above a stated amount without the necessity of entering into a facultative agreement for each one.

exempts mortgage lenders from its requirement to obtain a certificate of authority from the State Corporation Commission in Va. Code Ann. §13.1-757.[25]

However, the ALTA 24-06 endorsement does not protect a lender if it conducts other activities that are not exempt under §13.1-757(B), even if making the loan itself is exempt. It only protects a lender if its making these loans is its only activity in the state. Policyholders with owners' policies don't need this endorsement because there is no "doing business" exclusion in the ALTA Owners Policy.

20. Survey

ALTA 25-06 (Same as Survey) and
ALTA 25.1-06 (Same as Portion of Survey)

Basic title evidence comes from two places, the recorder's office and surveys of the land. A search of the records in the recorder's office is common to every title insured, but not all title examinations include an examination of a current survey of the Land. If the buyer or borrower orders a current survey, or if there is an acceptable existing survey, the policyholder may have some concerns that the Land described in the recorder's documents is the same land shown on

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[25] **§13.1-757. Authority to transact business required.** - A. A foreign corporation may not transact business in the Commonwealth until it obtains a certificate of authority from the Commission.

B. The following activities, among others, do not constitute transacting business within the meaning of subsection A:

1. Maintaining, defending, or settling any proceeding;
2. Holding meetings of the board of directors or shareholders or carrying on other activities concerning internal corporate affairs;
3. Maintaining bank accounts;
4. Maintaining offices or agencies for the transfer, exchange, and registration of the corporation's own securities or maintaining trustees or depositories with respect to those securities;
5. Selling through independent contractors;
6. Soliciting or obtaining orders, whether by mail or through employees or agents or otherwise, if the orders require acceptance outside this Commonwealth before they become contracts;
7. <u>Creating or acquiring indebtedness, deeds of trust, and security interests in real or personal property;</u>
8. <u>Securing or collecting debts or enforcing deeds of trust and security interests in property securing the debts</u>;
9. Owning, without more, real or personal property;
10. Conducting an isolated transaction that is completed within 30 days and that is not one in the course of repeated transactions of a like nature;
11. For a period of less than 90 consecutive days, producing, directing, filming, crewing or acting in motion picture feature films, television series or commercials, or promotional films which are sent outside of the Commonwealth for processing, editing, marketing and distribution. The term "transacting business" as used in this subsection shall have no effect on personal jurisdiction under § 8.01-328.1; or
12. Serving, without more, as a general partner of, or as a partner in a partnership which is a general partner of, a domestic or foreign limited partnership that does not otherwise transact business in the Commonwealth.

C. The list of activities in subsection B is not exhaustive. [*Emphasis added*].

the survey. The insured can tie these two sources together by asking for a "same as survey" endorsement.

Property descriptions can change from one survey to the next because the surveyors may use different base points, and, of course, technology has greatly improved the accuracy of surveys. In many cases, the documents will use a historical description and the survey will show the results of the surveyor's own measurements. That can make the policyholder uneasy.

a. ALTA 25-06 Same as Survey Endorsement

The ALTA 25-06 can be used where the title insurer is confident that the property description in Schedule A of the policy is the same land as that shown in the survey, even if the calls for the metes and bounds differ in the two documents.

b. ALTA 25.1 Same as Portion of Survey Endorsement

The ALTA 25.1-06 is used where the survey shows more land than the Land insured in the policy. For example, if a buyer is purchasing an outlot in a shopping center and doesn't want to pay for a survey of just the outlot because it is adequately depicted in a survey of the entire shopping center, the title insurer can accept the shopping center survey and issue an ALTA 25.1 designating the outlot as the Land.

21. Subdivision

ALTA 26-06 (Subdivision)

Until the 2006 ALTA policies, Exclusion 1 of the policies provided:

> The following matters are expressly excluded from the coverage of this policy:
>
> Any law, ordinance or governmental regulation (including but not limited to building and zoning ordinances) restricting or regulating or prohibiting the occupancy, use or enjoyment of the land, or regulating the character, dimensions or location of any improvement now or hereafter erected on the land, or prohibiting a separation in ownership or a change in the dimensions or area of the land, or any parcel of which the land is or was a part. [*Emphasis added*].

That last clause in the exclusion (this is the 1984 revision language that continued through the 1992 policies) was intended to describe subdivisions of the land. Many policyholders failed to grasp what the clause addressed, until they had a claim about an improper subdivision. Others recognized the exclusion and asked for an endorsement to cover subdivision risks. The California Land Title Association developed a CLTA 116.7 Subdivision Map Act Compliance endorsement decades ago, but it had to be altered for use outside the state because it insured compliance with the Subdivision Map Act, CAL. GOV. CODE §66410, *et seq*.

The language "Any law, ordinance or governmental regulation . . . restricting or regulating or prohibiting . . . prohibiting a separation in ownership or a change in the dimensions or area of the land, or any parcel of which the land is or was a part." lasted until 2006. With the new policies, the ALTA dropped the obscure reference to subdivision and substituted the word itself in both Covered Risk 5(c) and Exclusion 1(a)(iii). Covered Risk 5 now insures against

> 5. The violation or enforcement of any law, ordinance, permit, or governmental regulation (including those relating to building and zoning) restricting, regulating, prohibiting, or relating to . . .
>
> (c) the subdivision of land; or
>
> if a notice, describing any part of the Land, is recorded in the Public Records setting forth the violation or intention to enforce, but only to the extent of the violation or enforcement referred to in that notice.

So a subdivision endorsement is unnecessary if the title insurer misses a notice in the Public Records. If there is no notice the title insurer would not be liable under the policy. The ALTA 26-06 has no requirement that there be notice in the Public Records, so it extends the policy coverage by an assumption of the risk of loss by the title insurer due to a subdivision violation not noticed in the Public Records.

22. Usury

ALTA 27-06 (Usury)

Title insurance policies insure against title and lien risks, so a usury endorsement insures against:

> loss or damage sustained by the Insured by reason of the invalidity or unenforceability of the lien of the Insured Mortgage as security for the Indebtedness because the loan secured by the Insured Mortgage violates the usury law of the state where the Land is located.

The ALTA 27-06 endorsement does not insure against a loss caused by a judgment that the debt is unenforceable, or against penalties assessed against the insured because the loan is usurious. Title insurers are restricted to insuring the title or the lien of the mortgage, and cannot insure the validity or enforceability of the debt itself.

A title insurer will generally require that the loan fit into a statutory exemption before it will offer a usury endorsement. In Virginia, VA. CODE ANN. §6.1-330.61 provides the following exemption:

> No person shall, by way of defense or otherwise, avail himself of the provisions of this chapter or any other section relating to usury to avoid or defeat the payment of interest, or any other sum, upon a loan made to a person by a bank, savings institution, industrial loan association or credit union, provided the initial principal amount of the loan is $5,000 or more.

At first, the coverage sounds disappointing, but lenders use the coverage to determine if their loans meet a statutory exemption. If the title insurer gives the coverage, the loan should be exempt. If the title insurer must calculate the interest rate to determine if the loan is usurious, most companies will not issue the endorsement. So the lender can take comfort from the endorsement even if the coverage is not everything it would like to have.

23. Easements

ALTA 28-06 (Easement – Damage or Enforced Removal) and ALTA 28.1-06 (Encroachments – Boundaries and Easements)

Occasionally review of a survey will show a building that encroaches on an easement. Buyers of policies who see an exception for such an encroachment will often ask for some "affirmative" coverage over the risks posed by the encroachment. The title insurer cannot insure that the encroachment does not exist, because it does.

a. ALTA 28-06 Easement – Damage or Enforced Removal Endorsement

We often receive requests for coverage against loss caused by "any exercise or attempted exercise of the right of use or maintenance of the easement referred to in exception ___." Of course, if the survey shows an active pole line or manholes in the right of way, it would be imprudent to insure an owner against the right to use or maintain the easement. A title insurer who did that would create a claim merely by issuing the policy.

That requested coverage is even broader than the lender's coverage in a 2006 ALTA 9 endorsement, which provides in paragraph 3:

> 3. Damage to existing improvements, including lawns, shrubbery, or trees, located or encroaching on that portion of the Land subject to any easement excepted in Schedule B, which damage results from the exercise of the right to maintain the easement for the purpose for which it was granted or reserved.

The ALTA 9 originated in California where lawns shrubbery and trees are often coaxed out of desert soil and conditions. In the eastern U.S., it is unthinkable to give coverage against damage to trees to an owner because our utility companies try to prevent power outages by trimming back trees, often with painful results. With a little more editing, we can craft an endorsement that makes sense.

> The Company insures against loss or damage sustained by the Insured by reason of:
>
> (1) damage to an existing building located on the Land, or
>
> (2) enforced removal or alteration of an existing building located on the Land,
>
> as a result of the exercise of the right of use or maintenance of the easement referred to in Exception ___ of Schedule B for the purpose for which it was granted or reserved.

It's not perfect, though. On reflection, I would revise "an existing building located on the Land" to read "a building located on the Land at Date of Policy" to make it a little more precise. The word "existing" is unnecessarily vague.

b. ALTA 28.1-06 Encroachments- Boundaries and Easements Endorsement

The ALTA added boundary encroachment coverage, copied from the ALTA 9, into Covered Risk 2(c) of the 2006 owners and loan policies, but did not include the coverage for encroachment over easements located on the Land. When the ALTA 9.1 to ALTA 9.3 were revised to eliminate the encroachments in 2012, coverage, the ALTA added this ALTA 28.1-06 so that encroachment coverage can be restored if appropriate. Section 2 of the endorsement adds

a definition of "Improvement" which "means an existing building, located on either the Land or adjoining land at Date of Policy and that by law constitutes real property." Section 3 contains the insuring provisions:

> 3. The Company insures against loss or damage sustained by the Insured by reason of:
>
> a. An encroachment of any Improvement located on the Land onto adjoining land or onto that portion of the Land subject to an easement, unless an exception in Schedule B of the policy identifies the encroachment;
>
> b. An encroachment of any Improvement located on adjoining land onto the Land at Date of Policy, unless an exception in Schedule B of the policy identifies the encroachment;
>
> c. Enforced removal of any Improvement located on the Land as a result of an encroachment by the Improvement onto any portion of the Land subject to any easement, in the event that the owners of the easement shall, for the purpose of exercising the right of use or maintenance of the easement, compel removal or relocation of the encroaching Improvement; or
>
> d. Enforced removal of any Improvement located on the Land that encroaches onto adjoining land.

As you can see, the endorsement repeats the boundary coverage in Covered Risk 2(c) of the policy together with the ALTA 9 coverage for encroachments onto easements. Section 4 allows the title insurer to except some encroachments from this coverage, if necessary.

c. ALTA 28.2-06 Encroachments- Boundaries and Easements Endorsement

The ALTA 28.2-06 was adopted on April 2, 2013 to add flexibility to the ALTA 28.1-06. In the ALTA 28.1-06 "Improvement" meant "an existing building, located on either the Land or adjoining land at Date of Policy and that by law constitutes real property." The ALTA 28.2-06 changed the definition to "each improvement on the Land or adjoining land at Date of Policy, itemized below: ____________" giving a space for the parties to define the improvements that the coverage would apply to.

24. Interest Rate Swaps

ALTA 29-06 (Interest Rate Swap - Direct Obligation),
ALTA 29.1 (Interest Rate Swap - Additional Interest),
ALTA 29.2-06 (Interest Rate Swap-Direct Obligation - Defined Amount) and
ALTA 29.3 (Interest Rate Swap-Additional Interest - Defined Amount)

a. Interest Rate Swap Transactions

Interest rate swaps are "derivative" transactions, so they intimidate title insurance employees who haven't done that much work with them. Actually, the title insurance role is quite simple, even though derivatives can be complex. Borrowers enter into interest rate swaps to fix all or a part of the cost of borrowing. So how does a swap work?

It's easiest to begin with an illustration. Able, LLC borrows $20,000,000 from National Bank with the loan to be secured by a mortgage from Able. National Bank is only willing to lend with a variable rate, let's say LIBOR plus two points, even though Able had applied for a fixed rate loan expecting inflation in the future. To simplify matters, let's say that the loan provides for one payment at the end of each year of its ten year life.

To fix the rate (a goal that National Bank agrees with) National Bank offers Able an interest rate swap. The swap has a "notional amount" of $20,000,000 to match it to the principal indebtedness of the mortgage loan. The notional amount could be less if the parties decided to hedge only a portion of the loan. Using this notional amount, Able and National Bank agree to pay each other at year end (i) at a fixed rate of 6% of the notional amount from Able to the bank and (ii) at a variable rate of LIBOR plus two points from the bank to Able. Of course, to simplify matters, the parties will net out their obligations so the party that owes more will pay that excess to the other.

With the swap, Able will owe National Bank a payment of 6% of the $20,000,000 notional amount on the swap and another payment of LIBOR plus two points on the $20,000,000 mortgage indebtedness. At the same time, National Bank will owe Able a payment of LIBOR plus two points on the $20,000,000 notional amount of the swap. The result after netting everything out is that Able will pay National Bank 6% on $20,000,000, or $120,000.

Let's imagine, at the end of the first year, that LIBOR is 3%. In the swap, Able is obligated to National Bank for $120,000 and National Bank is obligated to Able in the amount of $100,000, so Able pays the bank $20,000. In addition, Able must pay the bank interest on its loan of LIBOR plus two, or $100,000. It pays a total of $120,000 to National Bank. Looking at the swap, it appears that the bank "wins" this round because Able lost the advantage of the low variable rates.

The next year that dreaded inflation kicks in, so by the end of the year, LIBOR is now 6%. In the swap, Able is obligated to National Bank for its $120,000, but this time National Bank is obligated to Able in the amount of $160,000 (8% of $20,000,000), so National Bank pays Able $40,000. Able must also pay the bank $160,000, so at the end of the day Able has paid $120,000 for its loan and swap. This time Able "wins" in the swap.

When Able borrowed the $20,000,000, National Bank was unwilling to accept the risk of interest rate fluctuations, but after they entered into the swap agreement, Able transferred that risk back to the bank. Why was the bank willing to accept a risk in a swap that it was unwilling to accept in the mortgage loan? When the bank set up the swap to hedge Able's interest rate risk, it also re-hedged that risk with another swap. In the swap agreement, Able agreed not only to net payments, but also to pay the expense of re-hedging the bank's hedging swap if Able defaulted on the swap. The damages for a default are often called "breakage."

If the bank must seek indemnification for the breakage from Able after a default on the swap, the bank should be concerned about Able's ability to pay. If Able defaults on its mortgage loan, the bank can recover its loss by foreclosing on the mortgage (at least that's the theory), so if the bank secures Able's reimbursement obligation for the breakage with the mortgage, it can be a secured creditor as to both.

b. Master Interest Rate Swap Agreements

The typical swap agreement is an International Swap Dealer's Association (ISDA) Interest Rate Swap Agreement. It provides for the details of an interest rate swap and when complete, the swap is in effect.

In some cases, the borrower and swap provider enter into an ISDA "Master Interest Rate Swap Agreement" that provides that the parties may confirm an actual interest rate swap in the future. There may be no swap in place at the loan closing, even if the master agreement has been fully executed. There is no law that supports viewing an interest rate confirmation in the future as creating a breakage reimbursement obligation that relates back to the date of the mortgage securing it, as often happens with future advances of indebtedness.

c. ALTA 29-06 Interest Rate Swap Endorsement – Direct Obligation

The simple way to secure a swap obligation is to identify it as an obligation secured by the mortgage, just as a note is secured. If the mortgage secures such a direct obligation, then a title insurer can insure that the mortgage secures the obligation with an ALTA 29-06 Interest Rate Swap – Direct Obligation endorsement. That sounds easy, but the swap must be in place when the endorsement is issued, and swaps are not always confirmed when the borrower closes the loan. The ALTA 29-06 only insures swap obligations in existence on the date the endorsement is issued, so if the parties confirm a swap after the endorsement was issued, it will not be insured. To insure a later confirmation, the swap provider must seek an endorsement to its loan policy.

One problem with the direct obligation method is that it requires the lender to increase the amount secured by the mortgage by the estimated amount that a rehedging swap will cost. Usually that estimate is ten percent of the notional amount. So in the case of the Able mortgage, the amount secured should be $20,000,000 plus $2,000,000 or $22,000,000. In a state having no mortgage tax, that isn't a barrier. In a state with a significant mortgage tax, that extra 10% for a contingent obligation can be a material amount.

d. ALTA 29.1-06 Interest Rate Swap Endorsement – Additional Interest

If the mortgage secures the breakage as "additional interest" and the mortgage loan contains an additional interest provision that will be triggered by a swap default to fund the breakage, the mortgage can secure the principle amount of $20,000,000 in our illustration, and still secure the amount needed to rehedge the swap. It's more complex, but in some states the mortgage tax savings may make this method worth the effort. Of course, if the mortgage secures the indebtedness and additional interest to fund the breakage, it should be insured with an ALTA 29.1 Interest Rate Exchange – Additional Interest endorsement. Like the ALTA 29, the ALTA 29.1 only insures breakage if the swap exists at the date of Endorsement.

e. ALTA 29.2-06 Interest Rate Swap Endorsement – Direct Obligation – Defined Amount

The ALTA 29-06 and ALTA 29.1-06 allow the Insured to apply the full amount of the policy to a loss to the Indebtedness or to the swap or to allocate the loss as it pleases. In 2011, the ALTA adopted the Defined Amount variations of the two endorsements that sets a separate

amount for the swap obligation, so the Indebtedness loss will be limited by the Amount of Insurance, and the swap loss will be limited by the endorsement.

f. ALTA 29.3-06 Interest Rate Swap Endorsement – Additional Interest-Defined Amount

The ALTA 29.3 is the Defined Amount variation for swap transactions secured as additional interest.

25. Shared Appreciation

ALTA30-06 One to Four Family Shared Appreciation Mortgage, and
ALTA 30.1-06 Commercial Participation Interest

In the 1980's the ALTA Forms Committee drafted a shared appreciation mortgage endorsement using the ALTA 6 Variable Rate Mortgage Endorsement as a model, but did not adopt the form as an ALTA form. It circulated as a model to use in the rare occasions that such an endorsement was needed. The Forms Committee decided not to adopt it as an ALTA form because there was not sufficient demand for such an endorsement. In 2010, the Forms Committee reconsidered and updated the old model so it could adopt it as an ALTA form.

a. ALTA 30-06 One to Four Family Shared Appreciation Mortgage Endorsement

The ALTA 30 One-to-Four Family Shared Appreciation Mortgage endorsement is designed only for residential mortgages where the additional interest is based on the appreciation in value of the home. The ALTA Forms Committee expects shared appreciation to become more popular in some of the residential workouts now underway. If a refinancing or modified mortgage contains a shared appreciation feature, the endorsement insures that the feature is secured by the mortgage. This endorsement defines Shared Appreciation as "increases in the Indebtedness secured by the Insured Mortgage by reason of shared equity or appreciation in the value of the Land." The insurance is modeled on the ALTA 6 coverage for variable interest rates. It was adopted on July 26, 2010.

b. ALTA 30.1-06 One to Four Family Shared Appreciation Mortgage Endorsement

The commercial variation was adopted more than two years after the ALTA 30-06 on August 2, 2012. The most significant difference between the two endorsements lies in the definition of Participation Interest in Section 2(b) of the endorsement:

> a. "Participation Interest" means those elements of interest, established and calculated pursuant to the formula provided in the Loan Documents, that are payable or allocated to the Insured based upon:
>
> i. the borrower's equity in the Title;
>
> ii. the increase in value of the Title; or
>
> iii. cash flow.

In addition, the ALTA 30.1-06 has a different set of exceptions from coverage in Section 4. They are less focused on consumer protection issues.

26. Severable Improvements

ALTA 31-06 Severable Improvements Endorsements

The title insurance industry wrestled with issues posed by expensive machinery anchored to a foundation for years before deciding that these projects really require standard forms to address the risks the developers were negotiating. Title insurers are limited to insuring the title to real property and liens on real property by statute in most states, so existing policies and forms don't address personal property.

In the industrial sector, there are large machines firmly attached to the real estate that occasionally caused discussions on valuation if the title to the real estate is lost. For example, a fourdrinier machine in a paper mill might be blocks long, and could better survive a tornado than almost any building, but it bolts to the foundation, so is it personalty or realty? It can become a significant issue if the title to the paper mill fails and the machine is either lost, or must be moved. If it is personal property, can the title insure ignore its effect on the amount of the loss?

In a wind farm, the developer is concerned about the turbines which must be dispersed over a fairly large area. Perhaps they are not as imposing as a fourdrinier, but each can represent a significant investment. They also pose valuation issues if a turbine must be moved because a title fails. If it can't be replaced, perhaps the developer will be unable to meet the generation capacity that the contract with the distribution utility requires.

The Forms Committee decided to use the term "Severable Improvement" in the ALTA 31-06 to designate a limited class of personal property and avoid misleading policyholders into thinking that the endorsement applies to all personal property.

> "Severable Improvement" means property affixed to the Land on or after Date of Policy that by law does not constitute real property because:
>
> a. of its character and manner of attachment to the Land; and
>
> b. it can be severed from the Land without causing material damage to it or to the Land.

So a wind turbine may be a Severable Improvement after it has been erected on its foundation, but a wind turbine in transit to the site is not. Other personal property, like vehicles, inventory, and the like, are not Severable Improvements.

If something qualifies as a Severable Improvement, the endorsement does not insure title to it, or insure that there are no liens that attach to it. It might be real property when attached but it is certainly personal property when it is not, so title insurers cannot insure the title to it. Instead, Section 2 of the endorsement allows a reduction in value of the Severable Improvement to be included in the calculation of the Insured's loss, and adds consequential damages for its removal, relocation and transportation up to 100 miles.

> 2. In the event of a loss by reason of a defect, lien, encumbrance, or other matter covered by this Policy ("Defect"), the calculation of the loss shall include (but not to the extent that these items of loss are included in the

valuation of the Title determined pursuant to Section 8 of the Conditions or any other endorsement to the Policy):

a. the diminution in value of the Insured's interest in any Severable Improvement resulting from the Defect, reduced by the salvage value of the Severable Improvement; and

b. the reasonable cost actually incurred by the Insured in connection with the removal or relocation of the Severable Improvement resulting from the Defect and the cost of transportation of that Severable Improvement for the initial one hundred miles incurred in connection with the relocation.

Section 4 of the endorsement makes it clear that it insures neither the title to or the nature of the "Severable Improvements" nor any security interest in them.

27. Construction Loan

ALTA 32-06 Construction Loan – Loss of Priority

ALTA 32.1-06 Construction Loan – Loss of Priority- Direct Payment

ALTA 32.2-06 Construction Loan – Loss of Priority- Insured's Direct Payment

The ALTA 32-06 was conceived as a replacement for the ALTA Construction Loan Policy. Early in the process, the ALTA Forms Committee decided to replace the policy with an endorsement, just as it had replaced the ALTA Leasehold Polices with the ALTA 13 and 13.1 leasehold endorsements. However, in this case, the process is not complete.

The ALTA Construction Loan Policy (10/17/92) differed from the basic ALTA Loan Policy in only two provisions. The Construction Loan Policy omitted the general coverage in the Loan Policy's insuring provision 7 for lack of priority over a statutory lien for services, labor or material for work contracted or begun before the Date of Policy, or if contracted or begun after the Date of Policy if the construction is financed or partly financed by the insured mortgage, and the advances are "obligatory." In addition, the Construction Loan Policy had an absolute exclusion for mechanic's liens instead of the limited exclusion in the ALTA Loan Policy.

This may sound counterintuitive, but the coverage for loss of priority to mechanics' liens was contained in four endorsements that were tailored to the different approaches to mechanic's lien priority in state statutes and codes. The title insurer would select the endorsement that suited local law and the circumstances of the transaction (many states allow some form of statutory priority for construction loans unless the construction lender fails to record its mortgage before work is begun on the project). The endorsements were lettered A, B C & D.

Endorsement A was the "broken priority" endorsement that insured only to the extent that the Insured had disbursed funds for the work claimed in the notice of lien. Its coverage was limited to services, labor and material furnished prior to a date stated in the endorsement. The date could be advanced with "date-down" endorsements issued after a title examination upon each disbursement of construction funds by the Insured. Endorsement A would be used in those states that do not allow priority of construction mortgage s over mechanic's liens, and in those states that allow priority, but the priority was broken by the failure of the construction lender to comply with the legislation giving it priority. This usually occurs when a construction lender

allows its borrower to begin construction in those states that require the mortgage to be filed before construction begins if it is to be prior to mechanics' liens.

Endorsement B insured a limited priority of construction advances by the Insured, but only for that portion disbursed in compliance with a legal obligation to disburse contained in a written agreement that existed when the endorsement was issued. Endorsement B was similar to insuring provision 7 of the ALTA Loan Policy (10/17/1992). Of course, if a disbursement was determined to be optional instead of obligatory, it would not be insured. As we have seen, it is not always easy to determine if a disbursement is obligatory or optional (*see*, pg. 42, supra). This endorsement applied in those states that give a construction lender priority for obligatory advances.

Endorsement C was also a limited priority endorsement, but it insured priority for construction loan advances made before a notice of mechanic's lien was filed in the Public Records. It was used in states that recognize priority of disbursements made before constructive notice of a mechanic's lien. Once a lien had been filed, priority was broken and the parties would have to revert to broken priority procedures if they decided to continue.

Endorsement Form D applied if the Insured had statutory priority over mechanic's liens. It gave unlimited priority coverage over mechanic's liens, and was the hands down favorite among construction lenders.

The ALTA Construction Loan Policy was never very successful. Although used in Illinois, it was ignored in most other states. However, the ALTA Forms Committee decided to replace it with these endorsements. Both the ALTA 32-06 and ALTA 32.1-06 address only the mechanic's lien broken priority risk.

In construction lending, title insurance does not insure against any loss arising from the occurrence of a filed notice of mechanic's lien after the Date of Policy. That coverage is so broad that it cannot be managed with the tools available to title insurers. For those who seek such coverage, the surety insurance industry is the place to look. The risk requires higher premiums and reserves than title insurers are allowed by state regulators, not to mention indemnities from developers that are often secured by mortgages.

Title insurance companies are restricted by statute to this single line of insurance. Even if a state does not have a single line restriction, the insurers are still limited because other states restrict title insurance to that single line no matter where the property insured is located. *See, e.g.,* CAL. INS. CODE §12360 (2012); and TEX. INS. CODE ANN. §2502.001(Vernon 2011). So, even if a title insurer's premium and reserve structure made this risk manageable, the "single line" restriction would prohibit them from competing with the surety industry.

So title insurers insure against a loss of the priority of the insured construction mortgage, generally limiting the risk to avoid assuming liability for disputes between developers, contractors and subcontractors and cost overruns. The role of a title insurer in a construction loan was best stated in *Bankers Trust Company v. Transamerica Title Insurance Company,* 594 F.2d 231 (10th Cir. 1979). The case involved the construction of an apartment complex in Colorado Springs, CO. After having made 13 construction disbursements, Bankers Trust declared the developer in default because it realized that construction funds from the borrower and the construction loan were inadequate because of cost overruns. Although Bankers Trust

still had $260,000 left undisbursed in its loan commitment when it foreclosed, it sought recovery of $325,871 in mechanic's lien claims from Transamerica. The court dismissed the Bankers Trust complaint saying:

> There is no basis in fact for any claim that Transamerica misapplied or failed to disburse properly the funds which were advanced through it as disbursing agent. Bankers characterizes the obligation of Transamerica under the disbursement agreement as a responsibility to pay the loan proceeds in such manner as would protect both the borrower and the plaintiff from mechanics' liens to the extent of the funds disbursed. That is accurate. Here, however, the difficulty is that the cost of the work performed was greater than the money made available for payment. Transamerica was obliged to protect against the possibility of plaintiff paying twice for the same work. The defendant did not assume any obligation to pay for this project itself if neither Bankers nor Breaks provided the necessary funds. 594 F.2d at 234.

The court in *Bankers Trust* defined a title insurer's liability for mechanic's liens in a construction loan policy that is consistent with the single line of insurance restriction on the industry and with the statutory definition of title insurance. Most title insurers accept *Bankers Trust* liability. That doesn't mean that all courts have agreed or have limited title insurer's liability in construction lending to diversion of funds only. Many have found reasons to expand a title insurer's liability for mechanic's liens. *See, e.g*., *American Savings and Loan Association v. Lawyers Title Insurance Corporation*, 793 F.2d 780 (6th Cir. 1986).

To create a replacement for the ALTA Construction Loan Policy and its Endorsement A, the ALTA adopted the ALTA 32-06 ALTA 32.1-06 and ALTA 32.2-06 endorsements to be added to the basic ALTA Loan Policy. The endorsements must clear some clutter from the policy, so the first Section of the endorsement deletes Covered Risk 11(a). In the 2006 ALTA Loan Policy, Covered Risk 11(a) replaced old insuring provision 7 in the 1992 ALTA Loan Policy, which was similar to Endorsement B, and it insured against loss or damage caused by:

> 11. The lack of priority of the lien of the Insured Mortgage upon the Title
>
> (a) as security for each and every advance of proceeds of the loan secured by the Insured Mortgage over any statutory lien for services, labor, or material arising from construction of an improvement or work related to the Land when the improvement or work is either
>
> (i) contracted for or commenced on or before Date of Policy; or
>
> (ii) contracted for, commenced, or continued after Date of Policy if the construction is financed, in whole or in part, by proceeds of the loan secured by the Insured Mortgage that the Insured has advanced or is obligated on Date of Policy to advance;

The second section adds definitions for "Date of Coverage," "Construction Loan Advance," and "Mechanic's Lien." The definitions are new to the policy.

The "Date of Coverage" can coincide with the Date of Policy, but it only applies to the Mechanic's Lien coverages in Section 3 of the endorsement. It does not apply to the Covered

Risks or any other endorsement coverages. The policy does not insure against loss caused by the invalidity, unenforceability or lack of priority of the lien of the Insured Mortgage as to construction loan advances, so using this endorsement, the Insured must advance the Date of Coverage to the date of each Construction Loan Advance to bring forward the insurance in Section 3 of the endorsement. It is not automatic insurance for advances as in the case of the ALTA 14 series endorsements because in a broken priority situation, a Mechanic's Lien can take priority over the lien of the Insured Mortgage. That broken priority risk is managed by Section 3. As to other matters that might affect the title, but could not upset the priority of the Insured Mortgage, like later junior mortgages, judgments, etc.; the policy insures the priority of the lien of the Insured Mortgage as of the Date of Policy.

"Construction Loan Advance" is defined as "an advance that constitutes Indebtedness made on or before Date of Coverage for the purpose of financing in whole or in part the construction of improvements on the Land." This term is used in the definition of the term "Indebtedness" in Section 1(d)(iii) of the Conditions of the policy, but it was not a defined term.

A "Mechanic's Lien" is defined as any statutory lien or claim of lien, affecting the Title, that arises from services provided, labor performed, or materials or equipment furnished. This definition is a convenience.

Section 3 begins with the familiar insuring language "The Company insures against loss or damage sustained by the Insured by reason of: . . ." That is followed by three subsections.

Subsection 3(a) says: "The invalidity or unenforceability of the lien of the Insured Mortgage as security for each Construction Loan Advance made on or before the Date of Coverage; . . ." It is the basic coverage for invalidity and unenforceability modeled on Covered Risk 9 of the policy directed to Construction Loan Advances. It is not a very bold coverage because there is little risk that a Construction Loan Advance will invalidate the mortgage, but it should not be left out.

Subsection 3(b) insures against loss by "The lack of priority of the lien of the Insured Mortgage as security for each Construction Loan Advance made on or before the Date of Coverage, over any lien or encumbrance on the Title recorded in the Public Records and not shown in Schedule B." This is the coverage against loss of priority of the lien of the Insured Mortgage to a notice of Mechanic's Lien filed in the Public Records on the date of Coverage. It does not apply to unfiled Mechanic's Liens, which is the topic of Subsection 3(c).

The point of a title rundown before a construction disbursement is to check for any filed notices of Mechanic's Lien, so Subsection 3(b) gives the Insured crucial coverage for the disbursement process. If the ALTA 33-06 Disbursement Endorsement does not report any filing for a notice of Mechanic's Lien, it is a significant part of the evidence to the Insured that the project is not in trouble. If a notice of Mechanic's Lien is turned out in the title rundown, the construction lender will typically require more information from its borrower to determine if the borrower or the project is in distress.

a. ALTA 32-06 Construction Loan – Loss of Priority Endorsement

Section 3(c) is the only part of these three endorsements that differentiate each from the other. In the ALTA 32-06, Section 3(c) insures the unfiled Mechanic's Lien risk described in *Transamerica*. Section 3(c) in the ALTA 33-06 says:

> c. The lack of priority of the lien of the Insured Mortgage, as security for each Construction Loan Advance made on or before the Date of Coverage over any Mechanic's Lien, if notice of the Mechanic's Lien is not filed or recorded in the Public Records, *but only to the extent that the charges for the services, labor, materials or equipment for which the Mechanic's Lien is claimed were designated for payment in the documents supporting a Construction Loan Advance disbursed by or on behalf of the Insured on or before Date of Coverage*.

This provision takes careful reading. It does not insure against unfiled mechanic's Liens for all work performed and materials furnished before the Date of Coverage as many customers expect. The Date of Coverage identifies which Construction Loan Advances are insured, but a Construction Loan Advance pays for work that was performed before the billing submitted for its payment was prepared. It may take several weeks to bill for services, send the bill for payment, receive inspector verification of the work submitted in the billing and finally disburse the payment for that work. So the insurance for unfiled liens does not extend all of the way to Date of Coverage, it only insures that the money disbursed at Date of Coverage was not diverted from the project and was used to pay the billings submitted for that disbursement. As we shall see below, this coverage is subject to the exceptions in Section 4 of the endorsement.

If a lender refuses to disburse for any or all of a billing because the inspector disapproves of the work done, causing the contractor that submitted the bill to file a mechanic's lien, the endorsement does not insure over that mechanic's lien because the lender's funds were not disbursed for that work. Also, if the lender disburses the entire construction loan, but a contractor files a mechanic's lien because the cost of building exceeded the construction budget, the title insurer is not liable in this instance, either. It doesn't matter whether the Insured has fully disbursed the construction loan or not if a mechanic's lien is filed for work, unless the lender actually disbursed money to pay for that work and the money was diverted to some other purpose.

Insuring against possible construction disputes, cost overruns or any failure of the policyholder to disburse is a casualty risk that cannot be managed by a title search and examination, or by prudent disbursement monitoring practices. Title insurers are prohibited from assuming these casualty risks by the state legislation that defines title insurance and restrict title insurers from engaging in any other line of insurance.

b. ALTA 32.1-06 Construction Loan – Loss of Priority Endorsement – Direct Payment

Section 3(c) of the ALTA 32.1-06 is more restrictive than the ALTA 32-06. It still insures against diversion of funds, but in this case, only to the extent that that the title insurer paid that claimant directly, or gave the construction lender its written approval for the disbursement. This endorsement leaves open the question of how far does the coverage reach?

> c. The lack of priority of the lien of the Insured Mortgage as security for each Construction Loan Advance made on or before the Date of Coverage over any

> Mechanic's Lien if notice of the Mechanic's Lien is not filed or recorded in the Public Records, *but only to the extent that direct payment to the Mechanic's Lien claimant for the charges for the services, labor, materials or equipment for which the Mechanic's Lien is claimed has been made by the Company or by the Insured with the Company's written approval*.

For example, if the title insurer or lender disburses to a general contractor, it does not appear that that the endorsement insures against a lien for work performed by a subcontractor, even if the subcontractor's billing was part of the justification for the disbursement, and the lender intended that the disbursement pay that bill. The payment to the subcontractor was not 'direct,' so it was not insured by the endorsement. Most states allow the laborers working for the general contractor or a subcontractor to assert a mechanic's lien on the Title if the laborer is not paid by his or her employer, so this can become very complex. A construction lender must be very careful in its instructions to the title insurer (if it is to disburse the funds), or to seek approval for payment directly to each subcontractor, material supplier and workman on the project to comply with the endorsement and protect itself from derivative claims of subcontractors and laborers.

The underlined portion of Section 3(c) was added by the ALTA effective April 2, 2013 to conform the Section in the ALTA 32.1 and ALTA 32.2 to the same section of the ALTA 32-06.

c. ALTA 32.2-06 Construction Loan – Loss of Priority Endorsement – Insured's Direct Payment

The ALTA 32.1-06 and 32.2-06 are almost indistinguishable, but the AL:TA 32.1-06 is suitable if the title company disburses, and the 32.2-06 only applies when the Insured disburses. Section 3(c) of the ALTA 32.2-06 provides:

> The lack of priority of the lien of the Insured Mortgage, as security for each Construction Loan Advance made on or before the Date of Coverage over any Mechanic's Lien, if notice of the Mechanic's Lien is not filed or recorded in the Public Records*, but only to the extent that direct payment to the Mechanic's Lien claimant for the charges for the services, labor, materials or equipment for which the Mechanic's Lien is claimed has been made by the Insured or on the Insured's behalf on or before Date of Coverage*.

Unlike the ALTA 32.1-06, the ALTA 32.2 does not require the title insurer's written approval for each disbursement. For that reason, it is the better choice between the two for a construction lender that is disbursing the funds. However, like the ALTA 32.1-06, the ALTA 32.2-06 only covers payments made directly to the party entitled to a lien, so disbursement of all of the draw to a general contractor, allowing the general contractor to pay its materialmen, subcontractors and employees will not be adequate for insurance against mechanic's lien claims by those materialmen, subcontractors, employees or laborers.

Section 4 of each of these endorsements contains exceptions from the coverage of Section 3. In each case, Section 4 begins:

> 4 This policy does not insure against loss or damage (and the Company will not pay costs, attorneys' fees or expenses) by reason of any Mechanic's Lien arising from services, labor, material or equipment:
>
> a. furnished after Date of Coverage; or

Section 4(b) of the endorsements follows the insuring provision in Section 3(c) of the endorsement. In the ALTA 32-06, the Section 4(b) exception reads: ". . . not designated for payment in the documents supporting a Construction Loan Advance disbursed by or on behalf of the Insured on or before Date of Coverage." In the ALTA 32.1 it reads: ". . . to the extent that the Mechanic's Lien claimant was not directly paid by the Company or by the Insured with the Company's written approval." In the ALTA 32.2-06 it is quite similar to the ALTA 32.1-06, reading: ". . . to the extent that the Mechanic's Lien claimant was not directly paid by the Insured or on the Insured's behalf."

c. ALTA 33-06 Disbursement Endorsement

The ALTA 33 Disbursement Endorsement works together with any of the ALTA 32 Construction Loan Endorsements. Its primary role is to set the Date of Coverage immediately upon each construction disbursement by the Insured. It is not a typical datedown endorsement that advances the Date of Policy for all of the coverages in the policy, but a full datedown involves problems for both the title insurer and the Insured. The point of a date-down was to bring the construction loan draw into the coverage of the policy.

As we saw in the discussion of the ALTA 14 Future Advance and Revolving Credit Endorsements beginning on page 37, title insurance policies do not insure the validity, enforceability or priority of the lien of the insured mortgage as to advances or draws made after the Date of Policy. The ALTA 14 future advance endorsements are not suitable for construction loans because courts can view the risk of inchoate mechanics' liens as different from the potential for other liens intervening between the filing of a mortgage and the disbursement of an advance or draw. A construction lender is aware that contractors and materials suppliers are providing work and material to improve the value of the mortgaged land, and that they have an inchoate lien right to secure payment for their work or material. In addition, the construction lender's security interest in the land increases in value with the improvement. Courts may view the construction lender as having an almost fiduciary duty to make sure disbursements are paid to the contractors and materialmen and to check for possible filed liens before each draw. *See, e.g.,* N.Y. LIEN LAW §13(2) & (3) (McKinney 2012); *Lincoln Federal Savings and Loan Assoc. v. Platt Homes, Inc*., 185 N.J. Super 457, 449 A.2d 553 (1982). Certainly, when priority over mechanic's liens is lost, it makes no sense to insure the priority of the construction mortgage with endorsements like the ALTA 14-06.

The problem with updating the Date of Policy is twofold. First, a construction loan mortgage must also create priority over all subsequent matters, even if it has lost priority over filed or unfiled mechanic's liens. If the mortgage is a non-construction mortgage, the Insured is rarely interested in updating the Date of Policy because it wants the insurance to insure priority as of the time of recording. When a title insurer updates the Date of Policy, it must take exception to any new matters discovered in the title search, and it usually does that in Schedule B-1. Consequently, the construction lender risks losing coverage for matters originally insured by the policy because of exceptions taken in the datedown endorsements. Second, from the title insurer's perspective, there are coverages that are too difficult to update frequently, like survey matters that require a new current survey before each endorsement. The project is under construction, so there is a very real potential that a contractor may encroach over a setback line or easement area as it builds. Title insurers often manage this risk by taking an exception in the

endorsement to survey matters occurring after the Date of Policy, but that opens an issue as to when a certain encroachment or matter was actually created. The Date of Coverage update for the mechanic's lien risk only avoids both of these problems.

The title datedown for the ALTA 32-06 Construction Loan endorsements is most important for the coverage in Section 3(b), but it is also necessary for Section 3(c) and Section 4 of the endorsements. It doesn't apply to any of the other Covered Risks in the policy, or any other endorsements if it is used only to advance the Date of Coverage.

The ALTA 33-06 has optional provisions shown in brackets on the official form. They allow the customer and title insurer to agree to add these additional features without making the endorsement into a non-standard modification for the ALTA 33-06. The first two are in Section 1, which sets the Date of Coverage. Optional Section 1.a. allows the title insurer to indicate the amount of the current disbursement, and optional Section 1.b. allows the company to recognize the aggregate amount disbursed. I see little value in these optional provisions because they are not dispositive of the value of the Indebtedness defined in Section 1(d) of the Conditions of the policy. The old practice of insuring construction loans with a "pending disbursement" provision was dropped in the ALTA 32 Construction Loan Endorsements, so there is no need to keep a tally of the disbursements in the construction loan policy now. Section 8 (a) of the Conditions of the policy limits the title insurer's liability to the Insured by, among other things, the Indebtedness. Other portions of the Conditions also refer to the Indebtedness, so a competing reckoning of the disbursements in the datedown endorsements would only confuse the coverage.

Sections 2 and 3 of the endorsement provide for amendments to Schedules A and B of the policy respectively. In most cases where only the Date of Coverage is advanced, there would be no need to amend the policy. Section 3 also has optional provisions for amending Part I and Part II of Schedule B.

28. Identified Risk

ALTA 34-06 Identified Risk Coverage

An identified risk is a risk peculiar to the Title that is exposed in a title search and examination. In many cases, the title insurer can eliminate an identified risk in the process we call 'title clearance.' Clearing title is the process of correcting the problem. For example, if a borrower refinanced a mortgage several years ago, but the old mortgage was not released after it had been refinanced, a title insure may obtain a release for that paid off mortgage and clear the title of that encumbrance.

There are some matters that cannot be cleared for a reasonable cost, but they pose little risk of loss. Title insurance consumers often ask their title insurer to assume these risks.

Most of the standard title insurance coverage for identified risks gives precise coverage over a specific matter. For example, the ALTA 28-06 Easement - Damage or Enforced Removal Endorsement, *see,* page 69, insures against loss if the encroachment of a building over an easement causes the policyholder a loss resulting from damage to the building or its enforced removal or alteration. If the identified risk is some other matter, or the remedy in the ALTA 28-06 doesn't suit the circumstance, then it will not help the Insured.

The ALTA 34-06 permits the Insured and title insurer to agree on the definition of the Identified Risk, so this endorsement is much more flexible than an ALTA 28-06. Section 1 of the endorsement provides for the definition of the matter. The matter will be excepted in Schedule B and the definition of Identified Risk in the endorsement will refer to that exception.

Section 2of the endorsement insures against enforcement of the Identified Risk against the Title and the risk that the title is not insurable as a result of the Identified Risk:

2. The Company insures against loss or damage sustained by the Insured by reason of:
   a. A final order or decree enforcing the Identified Risk in favor of an adverse party; or
   b. The release of a prospective purchaser or lessee of the Title or lender on the Title from the obligation to purchase, lease, or lend as a result of the Identified Risk, but only if
      i. there is a contractual condition requiring the delivery of marketable title, and
      ii. neither the Company nor any other title insurance company is willing to insure over the Identified Risk with the same conditions as in this endorsement.

Why does Section 2.b. insure only 'insurable title' instead of Marketable Title as that term is defined in Section 1[26] of the Conditions of the policy? In this case, we have an identified risk, so if the title insurer gives coverage for Marketable Title over this Identified Risk, it will be liable to the Insured as soon as it delivers the policy. It becomes an unquantifiable and unmanageable risk because the policyholder could collude with a 'buyer' to bid an over market price for the Land, and then rescind the offer upon 'discovering' the Identified Risk. The title insurer would be liable for the lost gain on the 'failed' transaction. With this insurable title standard, the title insurer would be liable only if the potential buyer could find no title insurer willing to assume the risk under the same conditions that it was insured in the ALTA 34-06. Obviously, the company that issued the ALTA 34-06 in the first place can be expected to offer it to the buyer to avoid the claim.

Section 3 extends the title insurer's duty to defend the Insured as a result of the insurance in Section 2 of the endorsement. Section 4 excuses the title insurer from the duty of clearing the title of the encumbrance of the Identified Risk for the same reason that the insurer will only give insurable title coverage in Section 2.b. However, the title insurer may choose to clear the Title if that is the most efficient way to resolve a claim, and if it does clear the Title of the Identified Risk, Section 9(a) of the policy Conditions discharges the title insurer from any further liability as to that claim.

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[26] Sections 1(k) and 1(m) of the Conditions of the 2006 ALTA Owners and Loan Policies, respectively, define the term as:

(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.

29. Minerals and Other Subsurface Substances

ALTA 35-06 Minerals and Other Subsurface Substances – Buildings

ALTA 35.1-06 Minerals and Other Subsurface Substances – Improvements

ALTA 35.2-06 Minerals and Other Subsurface Substances – Described Improvements

ALTA 35.3-06 Minerals and Other Subsurface Substances – Land Under Development

Although the ALTA waited until April of 2012 before it produced its first dedicated minerals and other subsurface substances endorsements, the coverage has been available and generally used ever since the introduction of the ALTA 9 in 1988. Title insurers often see lists of endorsement requests that include the ALTA 9 and the CLTA 100.29 Minerals, Surface Damage endorsements. The coverages are virtually congruent. The ALTA 9 is derived from the CLTA 100 and the CLTA 100 endorsement series is a group of derivatives of the CLTA 100 and 100.2 (the ALTA 9 with a CLTA number). If you have an ALTA 9, you don't need the redundant insurance in the CLTA 100.29, but both are frequently requested together.

However, as we have seen in the discussion of the ALTA 9 Covenant endorsements, all of the owner's coverages and the ALTA 9.3-06 Loan coverage have been shortened to Covenants, Conditions and Restrictions endorsements because there are too many situations where grouping these coverages in a single endorsement makes the endorsement inappropriate. The CLTA 100 and ALTA 9-06 were designed for insuring commercial properties in a developed area where local laws would prevent surface mining or drilling operations. Especially with the advent of alternative energy production facilities like wind farms and solar power generation stations that need large rural areas, the possibility of interference with mining, drilling or hydraulic fracturing in the exploitation of subsurface substances exposes title insurers to more risk than the endorsement was designed to meet.

With the changes to the ALTA 9 Covenant endorsements, the pressure for dedicated mineral endorsements overwhelmed any resistance, resulting in the ALTA 35 Mineral and Subsurface Substances endorsements. The first Section in the endorsements is an incorporation preamble modeled on the beginning of the policy forms. The endorsements only differ among themselves in Section 2, all the other sections are identical.

Section 2 of the ALTA 35-06 defines Improvement as " . . . a building on the Land at Date of Policy." It is the most restrictive definition for Improvement, and it is intended to exclude other types of improvement like roadways, walkways, landscaping, etc. In the ALTA 35.1-06 the definition is expanded to mean " . . . a building, structure located on the surface of the Land, and any paved road, walkway, parking area, driveway, or curb, affixed to the Land at Date of Policy and that by law constitutes real property, but excluding any crops, landscaping, lawn, shrubbery, or trees." That definition includes the roadways and so forth, but does not include vegetation or landscaping.

The ALTA 35.2-06 allows the Insured and insurer to agree on a list of the included improvements. They might agree on the definition of Improvement in the ALTA 9-06, " . . . an improvement, including any lawn, shrubbery, or trees, affixed to either the Land or adjoining land at Date of Policy that by law constitutes real property." It is brief and not so precise as the

definition in the ALTA 35.1-06, but it does include lawn, shrubbery, or trees. On the other hand, a party may ask for this endorsement in a power generation plant development, so the definition of might be that "Improvement means an Electricity Facility as that term is defined in the ALTA 36-06 attached to this policy."

Finally, the ALTA 35.3-06 is a Land Under Development endorsement, so the definition of Improvement is the same as in the ALTA 35.1-06, but it also has definitions for Future Improvement" and "Plans" as in all other Land Under Development endorsements. It also adds future Improvements to the insuring provision in Section 3, the only difference in the endorsements for that section:

> 3. The Company insures against loss or damage sustained by the Insured by reason of the enforced removal or alteration of an Improvement or a Future Improvement, resulting from the future exercise of any right existing at Date of Policy to use the surface of the Land for the extraction or development of minerals or any other subsurface substances excepted from the description of the Land or excepted in Schedule B.

Section 4 of the endorsement contains the exceptions. It says:

> 4. This endorsement does not insure against loss or damage (and the Company will not pay costs, attorneys' fees, or expenses) resulting from:
>
>   a. contamination, explosion, fire, vibration, fracturing, earthquake or subsidence; [or]
>
>   b. negligence by a person or an Entity exercising a right to extract or develop minerals or other subsurface substances[; or
>
>   c. the exercise of the rights described in (   )].

Section 4(c) is optional and will only be used where the company has identified a mineral or other subsurface interest that it is unwilling to insure against. In that case, the exception in Schedule B of the policy will control over this endorsement.

30. Energy Projects

ALTA 36-06 Energy Project – Leasehold/Easement – Owner's

ALTA 36.1-06 Energy Project – Leasehold/Easement – Loan

ALTA 36.2-06 Energy Project – Leasehold – Owner's

ALTA 36.3-06 Energy Project – Leasehold– Loan

ALTA 36.4-06 Energy Project – Covenants Conditions and Restrictions – Land Under Development - Owner's

ALTA 36.4-06 Energy Project – Covenants Conditions and Restrictions – Land Under Development - Loan

ALTA 36.4-06 Energy Project – Encroachments

Over the past ten to twenty years customers building energy projects, especially wind farms, and members of the industry have developed many endorsements addressing issues

particular to electrical energy generation projects. Many of those endorsements were ill-conceived, so the ALTA felt pressure to develop a standard set of acceptable endorsements. During the process of developing these endorsements, the ALTA Forms Committee recognized that some of the older endorsements could benefit from the ideas proposed for the energy project endorsements. As we have seen, the ALTA 13 leasehold endorsements in particular were amended to incorporate new ideas generated in the development of the ALTA 36-06.

The one glaring omission from the ALTA 36 Energy Project Endorsements is an endorsement designed to give these coverage when the Title is a fee simple title. That is a reflection of the inception of these endorsements in wind farm projects. The early wind farm projects were built on leaseholds, and many still are. Some wind farm developers have moved to easements. The move to easements from leaseholds is because the developers may not be able to get optimal financing with leasehold mortgages. The easements are structured just like leases, so this may be a distinction without a difference.

If there is a fee simple parcel in the project and all of the easement parcels are connected to it, a title insurer can insure the easements as easements appurtenant, and that should give it no trouble. However, most of the easements cannot be described as appurtenant, so they are easements in gross. Under general common law principles, an easement in gross is not appurtenant to any estate in land, so it is a personal interest, or right to use the land of another that cannot be transferred or inherited. If it's not real estate, then a title insurer cannot insure it. However, if the easement in gross is for a commercial purpose and not for personal enjoyment, it becomes alienable as real property. *See*, *Sandy Island Corp. v. Ragsdale*, 246 S.C. 414, 143 S.E.2d 803 (1965); *Champaign Nat. Bank v. Illinois Power Co.*, 125 Ill. App.3d 424, 465 N.E.2d 1016 (1984); *Mumaugh v. Diamond Lake Area Cable TV Co*., 183 Mich. App. 597, 456 N.W.2d 214 (1990); *O'Donovon v. McIntosh*, 728 A.2d 681 (ME 1999). Since this line of cases modifies the common law, it is necessary to check the law of each state to see if that state agrees that commercial easements in gross are alienable.

The ALTA 36-06 insures leasehold and easement interests. The title insurer should make sure that the property descriptions in the policy do not include any properties that are burdened with an easement against impeding the wind flow or blocking the sunlight benefitting the Insured that might be confused with the easement giving possession of the land for development of the project. These endorsements begin with an incorporation preamble modeled on the beginning of the policy forms just like the ALTA 35 Mineral endorsements.

One of the urgent concerns of the wind power industry was the risk that a title insurer would value a leasehold for the site of only one wind turbine without taking into consideration its contribution to the value of the project as an integrated whole. The one site might be worth comparatively little, but the project may suffer a large loss if missing that turbine prevents the operator from meeting its power generation contract with the electrical distributor. Section 2 of the endorsement contains definitions, and the first definition is for the term "Constituent Parcel" which ". . . means one of the parcels of Land described in Schedule A that together constitute one integrated project."

a. ALTA 36-06 Energy Project – Leasehold - Easement Owner's

This endorsement is a variation of the ALTA 13-06 Leasehold Endorsement modified to insure projects built on leaseholds or easements in gross for a commercial purpose. The endorsement begins, as all of this series does, with a preamble that incorporates the endorsement into the policy provisions.

The definitions in Section 2 of the endorsement are extensive. They begin with a definition of 'Constituent Parcel' which begins recognition of losses for eviction from portions of the property as well as valuation of the project as an integrated whole. The next three definitions are for 'Easement,' 'Easement Interest' and 'Easement Term.' These definitions are necessary to establish the coverage for projects built on easements for a commercial purpose, but may also apply to any easements appurtenant serving the project. The definitions do not qualify the nature of the easement insured.

The next definition is for 'Electricity Facility' and it is certainly the most technical definition in the ALTA forms. Its list of equipment and facilities includes within the definition:

> . . . a substation; a transmission, distribution or collector line; an interconnection, inverter, transformer, generator, turbine, array, solar panel, or module; a circuit breaker, footing, tower, pole, cross-arm, guy line, anchor, wire, control system, communications or radio relay system, safety protection facility, road, and other building, structure, fixture, machinery, equipment, appliance and item associated with or incidental to the generation, conversion, storage, switching, metering, step-up, step-down, inversion, transmission, conducting, wheeling, sale or other use or conveyance of electricity . . .

However, the items on this list must be built or constructed on the Land as shown on the Plans and, when built, must constitute real property under local law. This is a Land Under Development endorsement, so there is the familiar definition for Plans in Section 2, as well.

So, what about items affixed to the Land that does not qualify as real estate? They are included in the definition of Severable Improvement. The term Severable Improvement is used to distinguish an item attached to the land from an item of personal property that is not attached to the land. Title insurers cannot insure title to personal property, even if it meets the definition of Severable Improvements, but Severable Improvements can be considered in the valuation of the Insured's loss. Section 2 of the endorsement also contains the familiar definitions of 'Evicted,' 'Eviction,' 'Lease,' Leasehold Estate,' 'Lease Term,' and 'Remaining Term' from the ALTA 13.

Section 3 of the endorsement contains the valuation provisions. Section 3(a) recognizes that eviction may be from a portion of the land. Section 3(b) acknowledges that a computation of loss for an eviction from any Constituent Parcel shall include loss or damage to the integrated project caused by the loss of the Constituent Parcel. This loss to the integrated project is a crucial feature for developers of wind farms, especially. Section 3(c) follows the ALTA 13 and allows the policyholder to value the ". . . Leasehold Estate, the Easement Interest, and any Electricity Facility affected by a defect . . ." valued either as a whole or separately. Section 3(d) prohibits duplication of recovery in valuing a loss. Section 4 provides for adding a diminution of the value of Severable Improvements to the calculation of the loss. Of course, the title insurer's liability for losses is still limited by the Amount of Insurance.

Section 5 of the endorsement covers additional items of loss for some items of consequential damages that are not generally available, except in the Leasehold Endorsements. These additional items of loss closely follow the additional items of loss in the leasehold endorsements described beginning on page 36 of these materials. Section 6 excludes the title insurer for liability caused by environmental damage or contamination.

b. ALTA 36.1-06 Energy Project - Leasehold - Easement Loan

This endorsement is a variation of the ALTA 13.1-06 Leasehold Endorsement modified to insure projects built on leaseholds or easements in gross for a commercial purpose. The coverages are similar to those in the ALTA 36-06, but add coverage for the lien of the Insured Mortgage.

c. ALTA 36.2-06 Energy Project – Leasehold - Owner's

This endorsement is a variation of the ALTA 36-06 Energy Projects – Leasehold-Easement Owner's endorsement, but without the definitions and insurance for easements. It retains the Land Under Development features of the two preceding endorsements.

d. ALTA 36.3-06 Energy Project- Leasehold - Loan

This endorsement is also a variation of the ALTA 36.1-06 Energy Projects – Leasehold-Easement Loan endorsement, but without the definitions and insurance for easements.

e. ALTA 36.4-06 Energy Project – Covenants Conditions and Restrictions – Land Under Development – Owners

This endorsement is an ALTA 9.8-06 modified to limit the coverage for a violation of a covenant to an Electricity Facility or a Severable Improvement only, so if an improvement of the landlord creates a violation, the title company will not be liable for that. It also has Land Under Development provisions, so it will insure against violations if a project is built according to the Plans referenced in the endorsement.

f. ALTA 36.5-06 Energy Project – Covenants Conditions and Restrictions – Land Under Development –Loan

This endorsement is an ALTA 9.7-06 modified to limit the coverage for a violation of a covenant to an Electricity Facility only, so if an improvement of the landlord creates a violation, the title company will not be liable for that. It deletes the mineral and encroachments coverages of the ALTA 9.7-06 because those issues must be underwritten separately if the title insurer agrees to give them.

g. ALTA 36.6-06 Energy Project – Encroachments

The ALTA 36.6-06 protects a policyholder from loss caused by encroachment of an Electricity Facility or a Severable Improvement either built or to be built according to the Plans identified in the endorsement onto adjoining property or onto an easement on the Land. It also insures that no improvement on adjoining land encroaches onto the Land described in the policy. This endorsement may be used on both loan and owner's policies.

31. Assignment of Rents and Leases

ALTA 37-06 Assignment of Rents and Leases

An assignment of rents and leases is an assignment of a non real estate interest, even though the assignments are usually recorded in the Public Records. As a consequence, title insurers cannot insure the validity, enforceability or priority of the assignment or include the assignment as an insured document in Schedule A. So the ALTA 37-06 endorsement insures against a defect in the execution of the assignment or the existence of a competing assignment recorded in the Public Records at the Date of Policy. It provides:

> 2. The Company insures against loss or damage sustained by the Insured by reason of:
>
>   a. any defect in the execution of the [Insert Title of Assignment of Rents or Leases Document] referred to in paragraph ____ [of Part II] of Schedule B; or
>
>   b. any assignment of the lessor's interest in any lease or leases or any assignment of rents affecting the Title and recorded in the Public Records at Date of Policy other than as set forth in any instrument referred to in Schedule B.

32. Mortgage Tax

ALTA 38-06 Mortgage Tax

Many jurisdictions impose a mortgage tax to record mortgages, and lenders face a risk that the mortgage may not be enforceable if the mortgage tax was not paid in full. The negotiations over the correct amount of mortgage tax may be complex. Imagine a $100,000,000 loan secured by mortgages on ten separate properties located in different states in 2010. Also imagine that the total value of the properties exceeds $200,000,000, so the loan to value ratio is about fifty percent of the value of each parcel. The borrower should be able to persuade the recorded that the allocated value for a site is $10,000,000, even though the mortgage secures $100,000,000 on a site worth $20,000,000 by appraisal. Later, upon foreclosure, imagine that the site is valued at $30,000,000, but the economy has improved since 2010. The recorder is suspicious and demands additional mortgage tax.

The mortgage tax is the responsibility of the Insured lender, so the title insurer cannot pay the additional tax, but it can insure that the mortgage is valid, enforceable and has priority as of its closing when the Insured pays the additional tax.

Section 2 of the ALTA 38-06 endorsement defines “Mortgage Tax” as a “recordation, registration or related tax or charge required to be paid when the Insured Mortgage is recorded in the Public Records.” Section 3 adds the insurance. It provides:

> 3. Upon payment of any deficiency in the Mortgage Tax, including interest and penalties, by the Insured, the Company insures against loss or damage sustained by the Insured by reason of:
>
>   a. the invalidity or unenforceability of the lien of the Insured Mortgage as security for the Indebtedness resulting from the failure to pay, at the time of recording, any portion of the Mortgage Tax; or

> b. the lack of priority of the lien of the Insured Mortgage as security for the Indebtedness resulting from the failure to pay, at the time of recording, any portion of the Mortgage Tax.

Section 4 excludes liability of the title insurer from a failure of the Insured to pay the Mortgage Tax. Section 5 excludes the title insurer from liability to pay the Mortgage Tax.

33. Policy Authentication

ALTA 39-06 Policy Authentication

The time for pre-printed endorsements is passing. Most issuing offices produce policy schedules and endorsements on their local printer. Commercial offices often produce and distribute policies and endorsements in electronic form. So endorsements are frequently issued without "wet signatures" to authenticate them. Section 14 (c) of the Conditions requires that "Any amendment of or endorsement to this policy must be in writing and authenticated by an authorized person, or expressly incorporated by Schedule A of this policy." Some title insurance customers have expressed concern that these emerging practices do not comply with Section 14(c). Title insurers have responded with endorsements, often unsigned, that ratify endorsements issued without wet signatures. An authentication endorsement poses problems for title insurers because many commercial customers ask for pro-forma policies before the closing, and adding an authentication endorsement might be construed as activating the pro-forma policy before the commitment requirements have been met.

The authentication endorsement is quite simple. It consists of a single sentence:

> When the policy is issued by the Company with a policy number and Date of Policy, the Company will not deny liability under the policy or any endorsements issued with the policy solely on the grounds that the policy or endorsements were issued electronically or lack signatures in accordance with the Conditions.

34. Boilerplate

The ALTA Forms Committee decided that even the boilerplate should be brought up to date with the new endorsements. It has applied it to all ALTA endorsements.

The old boilerplate read:

> This endorsement is made a part of the policy and is subject to all of the terms and provisions thereof and of any prior endorsements thereto. Except to the extent expressly stated, it neither modifies any of the terms and provisions of the policy and any prior endorsements, nor does it extend the effective date of the policy and any prior endorsements, nor does it increase the face amount thereof.

The new boilerplate sheds some archaic usage, and adds a second sentence to declare that the endorsement controls over any inconsistency in the policy or a previous endorsement. That would be implied under the general rules of construction, but now the endorsements say so.

> This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a

> previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

On January 17, 2004, the ALTA Board of Governors adopted the recommendation of the ALTA Forms Committee to substitute the new boilerplate into all of the ALTA endorsement forms. It now applies to all ALTA endorsements. In addition the ALTA included a complementary provision in subsection (d) of Conditions 14 and 15 of the 2006 Loan and Owner's policies respectively. If a title insurer inadvertently leaves off the boilerplate from an endorsement, these policy provisions will incorporate the endorsement into the policy without it. It's belts and suspenders.

In the revisions to the 2006 policies, it became evident that nothing in the policies addressed the effect of endorsements, and so Section 14(d) of the Conditions was added to the 2006 Loan Policy and section 15(d) was added to the 2006 Owners Policy to correct that deficiency. They say:

> (d) Each endorsement to this policy issued at any time is made a part of this policy and is subject to all of its terms and provisions. Except as the endorsement expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsement, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance.

A.
The ALTA Endorsements
(In numerical order)

Form	Name	Introduced	Current Revision
ALTA 1-06	Street Assessments	6/17/06	6/17/06
ALTA 2-06	Truth-in-Lending	6/17/06	6/17/06
ALTA 3-06	Zoning – Vacant Land	6/17/06	6/17/06
ALTA 3.1-06	Zoning – Completed Structure	6/17/06	10/22/09
ALTA 3.2-06	Zoning – Land Under Development	4/2/12	4/2/12
ALTA 4-06	Condominium	6/17/06	2/3/10
ALTA 4.1-06	Condominium	6/17/06	10/16/08
ALTA 5-06	Planned Unit Development	6/17/06	2/3/10
ALTA 5.1-06	Planned Unit Development	6/17/06	10/16/08
ALTA 6-06	Variable rate Mortgage	6/17/06	10/16/08
ALTA 6.2-06	Variable Rate Mortgage – Negative Amortization	6/17/06	10/16/08
ALTA 7-06	Manufactured Housing	6/17/06	6/17/06
ALTA 7.1-06	Manufactured Housing – Conversion; Loan	6/17/06	6/17/06
ALTA 7.2-06	Manufactured Housing - Conversion; Owners	6/17/06	6/17/06
ALTA 8.1-06	Environmental Protection Lien	6/17/06	6/17/06
ALTA 8.2-06	Commercial Environmental Protection Lien	10/16/08	10/16/08
ALTA 9-06	Restrictions, Encroachments, Minerals – Loan	10/19/88	4/02/12
ALTA 9.1-06	Covenants, Conditions & Restrictions – Owner’s Policy: Unimproved Land	10/17/98	4/02/12
ALTA 9.2-06	Covenants, Conditions & Restrictions – Owner’s Policy: Improved Land	10/17/98	4/02/12
ALTA 9.3-06	Covenants, Conditions & Restrictions – Loan	6/17/06	4/02/12

Form	Name	Introduced	Current Revision
~~ALTA 9.4-06~~	Restrictions, Encroachments, Minerals – Owner's Policy: Unimproved Land	6/17/06	Withdrawn 4/02/12
~~ALTA 9.5-06~~	Restrictions, Encroachments, Minerals – Owner's Policy: Improved Land	6/17/06	Withdrawn 4/02/12
ALTA 9.6-06	Private Rights	4/2/12	4/2/13
ALTA 9.7-06	Restrictions, Encroachments, Minerals – Land Under Development – Loan Policy	4/2/12	4/2/12
ALTA 9.8-06	Covenants, Conditions & Restrictions – Land Under Development – Owners Policy	4/2/12	4/2/12
ALTA 9.9-06	Private Rights – Owners Policy	4/2/13	4/2/13
ALTA 9.10-06	Restrictions, Encroachments, Minerals – Current Violations	4/2/13	4/2/13
ALTA 10-06	Mortgage Assignment	6/17/06	2/3/10
ALTA 10.1-06	Mortgage Assignment and Datedown	6/17/06	2/3/10
ALTA 11-06	Mortgage Modification	6/17/06	6/17/06
ALTA 11.1-06	Mortgage Modification with Subordination	10/22/09	10/22/09
ALTA 11.2-06	Mortgage Modification with Additional Amount of Insurance	4/2/13	Deferred
ALTA 12-06	Aggregation	1/27/97	4/2/13
ALTA 12.1	Aggregation – State limits	4/2/13	4/2/13
ALTA 13-06	Leasehold Owners	6/17/06	4/2/12
ALTA 13.1-06	Leasehold Loan	6/17/06	4/2/12
ALTA 14-06	Future Advances – Priority	6/17/06	2/3/11
ALTA 14.1-06	Future Advances – Knowledge	6/17/06	2/3/11
ALTA 14.2-06	Future Advances – Letter of Credit	6/17/06	2/3/11
ALTA 14.3-06	Future Advances – Reverse Mortgage	6/17/06	2/3/11
ALTA 15-06	Non-Imputation – Full Equity	6/17/06	6/17/06

Form	Name	Introduced	Current Revision
	Transfer		
ALTA 15.1-06	Non-Imputation – Additional Insured	6/17/06	6/17/06
ALTA 15.2-06	Non-Imputation Partial Equity Transfer	6/17/06	6/17/06
ALTA 16-06	Mezzanine Financing Endorsement	6/17/06	6/17/06
ALTA 17-06	Access and Entry	6/17/06	6/17/06
ALTA 17.1-06	Indirect Access and Entry	6/17/06	6/17/06
ALTA 17.2-06	Utility Access	10/16/08	10/16/08
ALTA 18-06	Single Tax Parcel	6/17/06	6/17/06
ALTA 18.1-06	Multiple Tax Parcel	6/17/06	6/17/06
ALTA 19-06	Contiguity – Multiple Parcels	6/17/06	6/17/06
ALTA 19.1-06	Contiguity – Single Parcels	6/17/06	6/17/06
ALTA 20-06	First Loss – Multiple Parcel Transactions	6/17/06	6/17/06
~~ALTA 21-06~~	Creditors' Rights	6/17/06	Withdrawn 2/3/10
ALTA 22-06	Location	6/17/06	6/17/06
ALTA 22.1-06	Location and Map	6/17/06	6/17/06
ALTA 23-06	Co-Insurance	1/1/08	10/16/08
ALTA 24-06	Doing Business	10/16/08	10/16/08
ALTA 25-06	Same as Survey	10/16/08	10/16/08
ALTA 25.1-06	Same as Portion of Survey	10/16/08	10/16/08
ALTA 26-06	Subdivision	10/16/08	10/16/08
ALTA 27-06	Usury	10/16/08	10/16/08
ALTA 28-06	Easement – Damage or Enforced Removal	2/3/10	2/3/10
ALTA 28.1-06	Encroachments – Boundaries and Easements	4/2/12	4/2/12
ALTA 28.2	Encroachments – Boundaries and Easements – described Improvements	4/2/13	4/2/13
ALTA 29-06	Interest Rate Swap – Direct Obligation	2/3/10	2/3/10

Form	Name	Introduced	Current Revision
ALTA 29.1-06	Interest Rate Swap – Additional Interest	2/3/10	2/3/10
ALTA 29.2-06	Interest Rate Swap – Direct Obligation – Defined Amount	8/1/11	8/1/11
ALTA 29.3-06	Interest Rate Swap – Additional Interest – Defined Amount	8/1/11	8/1/11
ALTA 30-06	One-to-Four Family Shared Appreciation Mortgage	7/26/10	7/26/10
ALTA 30.1-06	Commercial Participation Interest	8/1/12	8/1/12
ALTA 31-06	Severable Improvements	2/3/11	2/3/11
ALTA 32-06	Construction Loan – Loss of Priority	2/3/11	2/3/11
ALTA 32.1-06	Construction Loan – Loss of Priority	2/3/11	4/2/13
ALTA 32.2-06	Construction Loan – Loss of Priority – Insured's Direct Payment	8/1/12	4/2/13
ALTA 33-06	Disbursement Endorsement	2/3/11	2/3/11
ALTA 34-06	Identified Risk Coverage	8/1/11	8/1/11
ALTA 35-06	Minerals and Other Subsurface Substances – Buildings	4-2-12	4/2/12
ALTA 35.1-06	Minerals and Other Subsurface Substances – Improvements	4/2/12	4/2/12
ALTA 35.2-06	Minerals and Other Subsurface Substances – Described Improvements	4/2/12	4/2/12
ALTA 35.3-06	Minerals and Other Subsurface Substances – Land Under Development	4/2/12	4/2/12
ALTA 36-06	Energy Project – Leasehold/Easement – Owner's	4/2/12	4/2/12
ALTA 36.1-06	Energy Project – Leasehold/Easement – Loan	4/2/12	4/2/12
ALTA 36.2-06	Energy Project – Leasehold – Owner's	4/2/12	4/2/12

Form	Name	Introduced	Current Revision
ALTA 36.3-06	Energy Project – Leasehold – Loan	4/2/12	4/2/12
ALTA 36.4-06	Energy Project – Covenants, Conditions and Restrictions – Land Under Development – Owner's	4/2/12	4/2/12
ALTA 36.5-06	Energy Project – Covenants, Conditions and Restrictions – Land Under Development – Loan	4/2/12	4/2/12
ALTA 36.6-06	Energy Project – Encroachments	4/2/12	4/2/12
ALTA 37-06	Assignment of Rents or Leases	12/3/12	12/3/12
ALTA 38-06	Mortgage Tax	12/3/12	12/3/12
ALTA 39-06	Policy Authentication	4/2/13	4/2/13

B.

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