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A Beginner's Guide to the Commitment for Owner's Title Insurance

By Jack S. Levey

A client is buying an office building, a shopping center or other rental property. Its counsel just received a title insurance commitment. That lawyer has handled a few closings for single-family houses, but this is the lawyer's first commercial real estate deal. What to do now? Before reviewing the commitment and negotiating any necessary changes, counsel must understand the purpose of the commitment and the built-in exceptions to title coverage.

Reasons for Title Insurance

A purchase agreement often deals with many issues affecting title, including the form of title policy to be delivered, the type of defects to which the buyer can object and warranties or representations concerning the leases and tenancies. A buyer will typically want to add special coverage to insure that these representations and warranties are correct. If a tenant claims a renewal option years after closing, it may be more productive to make a claim under the title policy than to bring an action against the seller for breach of warranty. Of course, the buyer cannot make a claim under the policy unless it negotiated the necessary coverage when the title company first issued the policy.

If a client is borrowing money to finance a purchase, the lender will have its own additional requirements for the loan policy of title insurance. Those requirements are beyond the scope of this article, but buyer's counsel will usually be responsible for seeing that the lender's requirements are met.

What Is a Title Insurance Commitment Anyway?

A title insurance commitment is a contract to enter into a contract. The title insurance company, or underwriter, promises the proposed insured that if all the conditions set forth in Schedule B, Section 1 of the commitment are



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satisfied, the underwriter will issue an owner's policy of title insurance on the terms described in Schedule A of the commitment. Schedule B, Section 2 of the commitment lists the risks that the underwriter proposes to exclude from coverage. Usually, a title agency, or a lawyer, as agent for the underwriter, issues the commitment.

A title insurance commitment is not an abstract of title and will not necessarily list every arguable cloud on title. The agent ordinarily reviews the record title before issuing the commitment. The underwriter's internal policies and procedures, together with state law, will govern the scope of the examination. Not every search will go back to the government patent, or even to the root of title under marketable title statutes. As a result, Schedule B, Section 2 of the commitment ordinarily will show only those risks that the underwriter is unwilling to insure.

As a matter of business judgment, the underwriter may decide to insure certain known risks without disclosing them. For instance, in connection with an earlier refinancing by the seller, the title agency may have disbursed funds to a lender in full payment of an outstanding mortgage. If the mortgage was never satisfied of record, the unsatisfied mortgage is a cloud on the title. Nevertheless, in reliance on its agent's knowledge, the underwriter may elect to insure against the existence of the mortgage, without disclosing the mortgage in the commitment.

Title insurance policies are issued in different forms for different states. California, New York and Texas, in particular, have forms that are unique to those states. Most other states use some variation of the American Land Title Association (ALTA) form of policy. This article will focus on commitments to issue an ALTA owner's title insurance policy, and references to sections of the policy are to those of an ALTA policy.

Changes and Endorsements

Changes to the commitment are sometimes made by endorsement. Often, however, the agent will issue a completely revised commitment. The ALTA and the California Land Title Association use a number of standard endorsement forms for particular situations. Some ALTA endorsements are available in different forms to meet the differing requirements of the laws of various states.

Some states require all endorsements to be approved by the department of insurance or other regulatory authority, assuring uniformity among all underwriters. Other states permit each underwriter to promulgate its own form of endorsement, so long as the underwriter files the form with the regulatory authority. Still other states permit custom-tailored endorsements, sometimes called manuscript endorsements, that can be negotiated from deal to deal. Most underwriters maintain Web sites that list which endorsements they issue in a given state.

Examining the Commitment

The first step for buyer's counsel is to make sure that the commitment specifies which form of owner's title insurance policy the underwriter will issue. The final policy will be subject to the standard terms of that particular form. These terms exclude coverage for certain risks (often called "exclusions" to differentiate them from the Schedule B, Section 2 exceptions), impose procedural requirements for a claim, define policy terms and set the other fundamental terms of the policy.

The choice of forms is significant. For instance, the 1990 edition added a number of provisions, including mandatory arbitration, that lenders and owners often dislike. Many lenders and developers prefer the 1970 form, which may not be available in every state. If counsel is not familiar with the edition to be issued, he or she should ask the agent for a copy of the policy form and become familiar with it.

Different editions of the ALTA forms are in use in different states. Most underwriters' Web sites will list what forms of policy are available in a given state.

Exclusions from Coverage

The policy form will describe the exclusions from coverage. Two key exclusions concern creditors' rights and zoning.

- **Creditors' rights exclusion.** The creditors' rights exclusion in the 1990 ALTA form was overly broad. Underwriters were protected against their own delays (or failures) in recording the deed or mortgage. The exclusion could also be read to avoid coverage for claims resulting from failure of the deed, mortgage or other instrument to create the interest to be insured. These exclusions, of course, defeat the very reason for buying title insurance. Many owners and lenders refused to accept the 1990 ALTA form of policy.

ALTA fixed these problems in 1992. The 1992 revision (10/17/92) excludes claims based on state and federal fraudulent conveyance or fraudulent transfer laws. The 1992 form also excludes claims of preferential transfer, unless the preferential transfer results from a failure to record the instrument of transfer timely, or a failure of the recording to impart notice to a buyer for value or a judgment or lien creditor. The 1992 edition is currently available in at least 39 states.

- **Zoning exclusion.** The standard policies exclude coverage for damage caused by nonconformity with zoning or other land use laws. In many jurisdictions, parties can buy an ALTA 3.1 zoning endorsement, insuring against claims resulting from such nonconformity. The title insurer will charge an additional premium for this coverage.

Reviewing Schedule A

Schedule A sets forth:

- The name of the proposed insured,
- The amount of coverage,
- The estate or interest to be insured (usually fee simple),
- The name of the current fee owner and the source of the fee owner's title, and
- The legal description of the property.

Counsel should make sure that the name of the proposed insured is correct. Spellings, initials and abbreviations should match the buyer's legal name. If the purchase agreement has been (or will be) assigned, or if title will be taken by a nominee or assignee, the commitment should reflect that fact.

Partnership Buyers

If the buyer is a general partnership, its counsel should ask for a "Fairway" endorsement. Without that endorsement, the partnership risks losing its coverage if one or more partners later join or withdraw from the partnership. The endorsement is named for *Fairway Development Co. v. Title Insurance Co. of Minnesota*, 621 F. Supp. 120 (N.D. Ohio 1985). In *Fairway*, a partnership was denied coverage because two of the original three partners withdrew, and two new partners were admitted, after the title insurance policy was issued and before the defect in title was discovered. Even though the new partners continued the old partnership business under the same name, the court held that the insured owner ceased to exist when the partnership interests were transferred. The plaintiff was deemed a stranger to the title insurance policy, with no right to enforce the policy. As a result of *Fairway*, most underwriters now offer an endorsement agreeing that changes in the makeup of the partnership will not terminate the insurance.

Counsel should also make sure that any proposed *Fairway* endorsement fully addresses the problem. Some early forms of the Fairway endorsement promised continued coverage after admission or withdrawal of a partner "so long as no new partnership is formed," or "so long as the changes do not result in the dissolution of the partnership." Of course, under the Uniform Partnership Act, the addition or withdrawal of a partner automatically creates a new partnership and effects a dissolution of the old partnership. (There is a distinction between dissolution, which is a change in the legal relationship of the partners caused by the withdrawal or addition of a partner, and liquidation and winding up, which is the termination of the partnership's affairs.)

Depending on state law and the buyer's organizational documents, similar issues may arise in connection with a limited liability company (LLC) or limited partnership. For

this reason, some lawyers also ask for a Fairway endorsement when the proposed insured is an LLC or a limited partnership.

Corporate Buyers

A corporation is deemed a separate entity from its affiliates. If the original insured conveys the property to its subsidiary, the subsidiary will not be covered by the parent's title policy unless the underwriter consents to an assignment of the policy. The same is true of a deed from a corporation to its parent or sister corporation. A buyer should consider negotiating an endorsement allowing it to assign the policy to any corporation that controls, is controlled by or is under common control with the original insured. The best time to ask for this concession is when first ordering the commitment. After the policy is issued, there is much less leverage to obtain the coverage, unless the client's continuing business is particularly valuable to the underwriter.

Policy Amount

The policy amount will ordinarily match the purchase price. A purchaser should consider buying additional coverage if it plans to make significant improvements. The 1990 revisions to the ALTA owner's policy added a co-insurance provision that still appears in the current edition. If the coverage is less than 80% of the value of the property at the time the policy is issued, or if subsequent improvements increase the value of the property by at least 20%, the underwriter will discount payment of any partial loss. Some lawyers insist on the 1970 (revised 1984) policy form, which has no co-insurance provision. If the 1970 form is not available, consider asking for an endorsement to delete the co-insurance provision.

If the property consists of two or more parcels that are not used as a single site, a loss affecting fewer than all of the parcels will be allocated among them pro rata, regardless of actual value and exclusive of any improvements made after the date of policy. Buyer's counsel should ask for an "aggregation" endorsement, which makes the entire policy amount available for any loss affecting any portion of the property, or should obtain an endorsement allocating specific values to specific parcels of the property.

Legal Description

The legal description in Schedule A should match the description in the seller's source of title, the description in the purchase agreement and the description in the survey. If there are discrepancies among any of these, buyer's counsel should require an explanation and work with the surveyor until he or she is satisfied that the descriptions to be contained in the policy, the deed and the survey are consistent with each other and are correct.

If the property consists of two or more parcels, a contiguity endorsement, insuring that the parcels are contiguous

without strips, gaps, gores or overlaps, is often appropriate.

If the property benefits from easements, operating agreements, restrictive covenants or similar instruments affecting other property, the underwriter should include those rights in the description of the insured property. Buyer's counsel should consider ordering a separate title search for each easement or other instrument that benefits the property. Schedule B, Section 2 often shows an easement benefiting the property as though it were an exception, indicating that the easement burdens the property. The title company should delete any exception for the easement and show it as part of the insured estate.

Similarly, a given instrument may impose both a burden and a benefit on the property. For example, a shopping center may be subject to cross-access or cross-parking easements with a neighboring property or a reciprocal operating and easement agreement with other phases of the shopping center. Although such an easement is a legitimate exception to coverage in Schedule B, Section 2, it should also be described in, and insured as part of, the property under Schedule A.

Tips for Reviewing Schedule B, Section 1

Buyer's counsel should make certain that everyone agrees who is responsible for satisfying each of the requirements in Schedule B, Section 1. Many of these items will be within the seller's power to obtain-e.g., good standing certificates, certificates of tax clearance and affidavits as to certain facts. The title agency can help obtain satisfactions of mortgages, liens, judgments and other outstanding debts against the property. Often the creditor is willing to forward a release to the title agency in trust, to be recorded on payment to the creditor of a specified amount. On request, the title agency should be willing to contact those creditors to obtain written payoff statements and arrange for recording these documents.

The buyer controls satisfaction of some of the conditions. The commitment typically asks for copies of the buyer's organizational documents, certificates of good standing or licenses to do business as a foreign corporation/limited partnership/LLC. Ordinarily, the buyer should be able to satisfy these requirements with little difficulty.

Tips for Reviewing Schedule B, Section 2

Most title objections will arise out of Schedule B, Section 2. Of course, the purchase agreement will determine how much latitude the buyer has in objecting to matters of record.

The title company should include with the commitment a legible, complete copy of each instrument listed in Schedule B, Section 2 and a copy of any recorded plat to which the property is subject. When there are numerous instruments, a reviewer can use removable "sticky notes" to number each item, including the number assigned to the item in

Schedule B, the recording information and a short description of the item.

Counsel should check the survey against the list of exceptions, and vice versa, and insist that the title company revise the commitment so that any easements are limited to the area shown by the survey. Similarly, the surveyor should certify that the survey shows the location of each easement. Counsel should review the survey against the commitment to make certain that all easements are shown.

The Six "Standard" Exceptions

The buyer and its counsel should insist on deletion of the six so-called "standard" or "printed" exceptions.

1. The "gap" exception excludes coverage for matters that show up in the public records after the effective date of the commitment but before closing and recording of the deed. The agent can control this risk by re-checking the title shortly before closing and by controlling recordation of the documents. The agent will ordinarily remove the gap exception in reliance on a seller's affidavit.

2. The second printed exception excludes coverage for interests or claims that are not shown by the public records but that could be discovered by inspecting the land or by asking persons in possession. Each underwriter has its own form of seller's affidavit for removing this exception. In practice, the forms differ only slightly.

3. The policy will not insure against facts that a correct survey would disclose, unless those facts are shown by the public records. These facts may include conflicts in boundary lines, shortages in area or encroachments. The agent should agree to remove the survey exception if a current ALTA survey from a licensed surveyor is certified to the underwriter. Any encroachments, gaps or other problems revealed by the survey will still be excepted from coverage.

One must not confuse affirmative coverage of the survey with the so-called "same land" endorsement. The same land endorsement merely insures that the land described in the policy is the same land described in the survey. The same land endorsement does not insure the accuracy or completeness of the survey. Instead, the title company should delete the survey exception or limit it to matters shown by the specific survey certified to the underwriter.

4. The fourth standard exception rules out coverage for mechanics' liens that have not yet been filed of record. Removing this exception requires different steps in different states, reflecting the differences among their mechanics' lien statutes. An underwriter typically requires the seller to furnish an affidavit that no work on the property has been performed within the time limit for filing lien claims, except work that has been fully paid for.

Special problems may occur in those states in which liens against a project date back to the recording of a notice of commencement, particularly if the lien law makes no provision for filing notices of completion or abandonment. Stale notices of commencement from long-completed projects can still create a title problem. An underwriter should agree to remove exceptions for these stale notices of commencement if the seller furnishes an affidavit (perhaps coupled with an indemnity) that all work under the notice has been completed.

5. In most jurisdictions, possession of land puts the world on notice of the possessor's rights. Not surprisingly, the standard exceptions disclaim coverage against rights of parties in actual possession of the land. The agent should remove this exception on receipt of an appropriate affidavit from the seller. Of course, if the property is leased, an exception will still be made for rights of tenants.

The buyer should insist that any exception for rights of tenants be limited to rights of tenants under the terms of written leases disclosed to the insured in writing (or better yet, attach a list) to occupy the property as tenant under the lease. A blanket exception for "rights of tenants" or "rights of tenants in possession" leaves the buyer with the risk of undisclosed leases, oral tenancies and rights beyond those of occupancy. No buyer wants to learn after closing that its newly acquired tenant has a previously undisclosed right of first refusal or option to buy the property or expand into other premises or that it holds the exclusive right to sell a given category of merchandise in the shopping center.

Ideally, the purchase agreement will call for the buyer to receive a rent roll listing the tenants and to receive an estoppel certificate from each tenant. A properly drafted estoppel certificate will require the tenant to disclaim or disclose any options or other similar interests, as well as any claimed defaults, offsets or defenses. Nonetheless, a buyer should not settle for title insurance that excludes coverage for claims by tenants regarding options or other matters affecting title.

6. The final exception carves out special assessments and taxes not yet due. The agent should agree to remove this exception if the seller furnishes an appropriate affidavit.

Access

The title policy will insure that the property has legal access from a publicly dedicated street. This coverage, however, is not violated so long as the property has legal access from any public road. If the buyer is depending on the property's having access from one or more particular public streets (and for commercial property, the buyer probably is), counsel should ask for affirmative coverage that legal access is available from those specific streets and that the curb cuts furnishing access to those streets are located as shown on the survey.

Easements and Restrictions

Restrictions or covenants of record may establish standards for improvements or require the owner to have its construction plans approved in advance by the developer, an owners' association or other third party. Restrictions or covenants may also limit the purposes for which the property can be used. If title is subject to any restrictions of record, counsel should ask for an endorsement insuring that the existing improvements and use do not violate the restrictions and that past or future violations will not cause a forfeiture.

Restrictive covenants may grant a lien for assessments or other charges payable to an owners' association, the developer or other third party. If so, counsel should insist on affirmative coverage that all charges have been paid to date and that no liens currently exist. The agent will usually issue this coverage in reliance on an affidavit from the seller or a certificate from the owners' association.

As discussed above in connection with Schedule A, the commitment may show beneficial easements or restrictions as though they were exceptions to title. If easements or restrictions do in fact burden the property, amendments to the easement or restrictions may have limited or removed the burden. The commitment may erroneously show those amendments as though they increased the burden. Counsel should insist that the title company revise the commitment to remedy these errors.

Old Leases

A recorded lease can result in a title exception, even after the lease has expired by its terms. The agent will usually remove this exception based on a seller's affidavit. Similarly, if a lease has been terminated for default or abandonment, a simple affidavit from the seller will often persuade the underwriter to remove the exception.

Mortgages and Other Liens

The buyer should object to any monetary liens shown in Schedule B, Section 2. Buyer's counsel should insist that the commitment list the preconditions to satisfying, releasing or insuring over these items, and move the requirements-and all reference to the lien-to the list of conditions to coverage in Schedule B, Section 1.

Conclusion

This article outlines one approach for examining the title insurance commitment. Changes may be necessary depending on the terms of the purchase agreement, the laws of the jurisdiction in which the property is located or specific defects revealed by the survey or title commitment. Although every deal is different and deserves its own careful analysis, with an understanding of the title insurance commitment and the terms of the title

commitment policy, buyer's counsel will be ready to put together his or her own checklist as the deal requires.

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