

# Chapter 9



## Escrow & Title Insurance

### Chapter 9 Goals:

- Know the role of escrow
- Understand the basic escrow process
- Understand the job duty of the escrow agent
- What is title insurance
- Understand the different types of title insurance
- What is an impound account
- What is a title plant

## Chapter 9: Escrow & Title Insurance

*This chapter explores escrow, escrow agents, and the necessary requirements to close escrow. It will also explore title insurance and the different policies available.*

### Key Terms

abstract of title amendment to escrow instructions American Land Title Association (ALTA) beneficiary statement bilateral escrow instructions closing controlled escrow company	deed of reconveyance earnest deposit escrow escrow agent extended title insurance Homeowner's Coverage Policy impound account interpleader action joint escrow instructions	licensed escrow company opinion of title preliminary title report prorating rebate law standard coverage title insurance title plant unilateral escrow instructions
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## Escrow

### An Introduction

**Escrow** refers to the neutral third party that holds funds and/or documents on behalf of a client, to be disbursed once specific conditions have been met. The manner in which escrow acts is based on the conditions of a particular transaction.

In the case of real estate, escrow refers to a third party escrow company holding a buyer and seller's consideration in a transaction. This is typically a buyer's funds (i.e. deposit, down payment) and the title/deed to a seller's property. When all of the required conditions of a purchase agreement are met and the transaction "closes", both party's consideration is released to the other party.

In order for escrow to be valid, there needs to be a binding contract/agreement between a buyer and seller, as well as the delivery of a grant deed or deed of trust.

Section 17003 of the Financial Code defines escrow in legal terms:

*"...any transaction wherein one person, for the purpose of effecting the sale, transfer, encumbering or leasing of real or personal property to another person, delivers any written instrument, money, evidence of title to real or personal property, or other thing of value to a third person to be held by such third person until the happening of a specified event or to the performance of a prescribed condition, when it is then to be delivered by such a third person to a grantee, grantor, promisee, promisor, obligee,*

*obligor, bailee, bailor, or any agent or employee of any of the latter."*

Escrow minimizes risk and maximizes the chance of successfully closing a transaction. It protects the interests of both principals in a real estate transaction by enforcing a purchase agreement's mutually agreed-upon conditions and distributing consideration only when those conditions have been met.

Although escrow is not required for a real estate transaction, it is highly advised that all property sales be executed using escrow to ensure that all components of a transaction are followed.

## **Escrow Agent**

An **escrow agent** -- also known as an escrow holder, or simply an escrow -- is the neutral third party whose primary responsibility is to execute the instructions set forth by the principals in a real estate transaction.

An escrow agent is a limited/special agency relationship governed by specific escrow instructions. An escrow acts as a depository for the consideration used in the exchange (i.e. funds, assets, documents) and is responsible for executing the terms of a purchase agreement. This includes receiving and distributing a seller's property deed in exchange for a buyer's funds. (Escrow never actually holds the title to a property, however.)

A principal is responsible for dictating instructions to an escrow agent. Typically, this refers to the buyer and seller in a transaction. However, a lender providing a new loan for the purchase of a property may be an additional principal in a transaction. (Lenders are considered principals because they are responsible for executing instructions to the escrow agent for the transfer of real estate.)

Escrows are privileged and confidential in nature. An escrow agent must maintain the privacy of all principals and never disclose information to third parties without a principal's approval. Conversely, an escrow agent must communicate all acquired knowledge relating to the escrow process to the principals. This includes any detrimental or new material information that might affect a principal's decision regarding the pending transaction.

An escrow agent does not have discretionary authority. He or she acts on behalf of the principals, rather than in place of them.

An agent must also maintain complete neutrality during escrow. To the extent possible, an agent must avoid acting in a manner that results in the gain or detriment of one principal over the other. For this reason, an escrow agent cannot play the role of mediator.

In the event that a dispute arises amongst principals in escrow, the agent must wait for the principals to reach a resolution and give subsequent direction. Should a dispute fail to be resolved in a reasonable time frame, the escrow agent may go to the county court and file an interpleader action. An **interpleader action** is a civil procedure initiated by one party (escrow agent) which compels two or more other parties (principals) to resolve a dispute. Once the dispute is resolved, the agent will then enforce new instructions.

While an agent may offer advice to principals within the course and scope of the escrow instructions, the agent is prohibited from offering legal advice. Instead, an escrow agent must suggest that disagreeing parties consult an attorney, or a real estate broker when the transactional matter may be negotiated within the course and scope of the real estate license.

Escrow agents must retain a copy of all vital documents from current and previous transactions. An agent must constantly maintain records and files to be sure that a particular procedure is not being overlooked. Neat and orderly files, complete with check sheets, will help ensure a smooth progress in closing escrow.

Overall, an agent must maintain a high degree of trust, efficient service, and good public relations throughout the escrow process.

### **Case Review: *re Marriage of Cloney (2001)***

*In re Marriage of Cloney (2001)* 91 Cal.4<sup>th</sup> 429, an escrow agent did not disclose knowledge of a seller's name change to the buyer.

An escrow agent failed to disclose all vital information to a buyer. The escrow agent had full knowledge that the seller had changed **his/her** name, but did not disclose it to the buyer. This seller had a judgment lien on the subject property. The judgment lien on the seller's property caused the buyer to purchase a property free of liens which meant the buyer did not have full ownership of the subject property.

The Superior Court determined that it was the duty of the escrow agent to disclose information about the seller to the buyer, including a valid judgment lien recorded against a debtor with multiple names.

## **Escrow Licensing**

California real estate law defines an escrow agent as an individual or entity that holds a valid, unrevoked escrow agent license. It is unlawful for any individual or entity to

engage in escrow activity without a license issued by the Real Estate Commissioner (California Financial Code Section 17200).

Escrows are licensed as companies, not individuals. Escrow companies are either licensed or controlled.

### **Licensed Escrow Company**

A **licensed escrow company** is considered “independent”. The requirements to be become a licensed company are much more difficult than becoming a controlled escrow company.

A company must be licensed by the California Corporations Commissioner. Each licensed escrow company must have at least one agent with a minimum of five years of responsible escrow practice at the primary branch. Each additional location must have an escrow agent with a minimum of four years experience.

Potential agents must pass rigorous tests to ensure proper knowledge of the escrow process. A licensed escrow company must also perform extensive background checks on all of its employees and take fingerprints.

All agents who have access to money or securities must have a bond indemnifying them against loss of money or property (Business and Professions Code 17203.1). Licensed escrow companies must have a \$10,000 surety bond and must purchase a minimum \$125,000 bond for each employee.

### **Controlled Escrow Company**

A **controlled escrow company** -- also known as a non-licensed or “non-independent” escrow company -- is exempt from being licensed.

The process of becoming a controlled escrow requires less time and money than becoming a licensed escrow. Unlike licensed companies, controlled escrows are not required to purchase bonds for their employees, do background checks, or take fingerprints.

License-exempt agents may include:

- A broker
- An attorney
- A title insurance company
- Other real estate professional

Controlled escrow companies do not require a minimum amount of experience to be licensed. However, as brokers have the right to act as escrow agents without being

required to purchase fidelity or surety bonds, the Department of Real Estate does maintain a victim's fund for principals who are defrauded by escrow brokers. The maximum payout for victims of escrow fraud is \$50,000.

A broker-controlled escrow refers to when a broker is also the escrow agent. Brokers can only perform escrow services in a real estate transaction where a principal is already using the broker to buy or sell a property. If a broker advertises escrow services, it must be in addition to his or her primary real estate business. Brokers also cannot use a fictitious name with the word "escrow" in any forms, publications, or sign-offs.

Should a broker solicit escrow business outside of his or her primary real estate business, the broker may be subjected to a cease and desist order from the Department of Real Estate.

## **The Escrow Process**

### **Finding Escrow Agent**

As a buyer typically initiates a real estate transaction, he or she is generally responsible for finding an escrow agent. However, principals may select an agent together if they choose.

Real estate brokers and/or agents cannot select an escrow agent on behalf of their principals. They also may not require either principal to buy or sell a property contingent on which escrow company is used. However, if both principals cannot agree on a suitable escrow company, an agent may recommend one.

In a refinance situation, brokers or lenders generally choose the escrow company.

### **Opening Escrow**

Typically, escrow opens immediately after the seller accepts the buyer's purchase agreement. The broker will send the details of the transaction to the escrow agent. Upon verification of these details, the escrow agent will prepare escrow instructions.

### **Escrow Instructions**

Escrow instructions indicate the obligations required of a buyer and a seller in order to close escrow. Any party who submits escrow instructions is considered a principal. This includes lenders who are providing buyer financing; they will send their own instructions to escrow.

Unless given authorization by the principals, an escrow agent may only accept claims, funds, or documents laid out in the escrow instructions.

Properly drawn escrow instructions should be clear as to the understandings and intentions of both principals, the duties of the escrow agent, and the fact that it is the principals themselves who must perform the agreed-upon escrow instructions.

In California, principals typically use a form called the California Purchase Agreement and **Joint Escrow Instructions**, which include all components of a transaction on a single form. It is possible, however, to have a purchase agreement and escrow instructions that are separate from one another.

There are two types of escrow instructions: unilateral and bilateral. **Unilateral escrow instructions** refer to separate instructions for each principal, while **bilateral escrow instructions** refers to the same instructions being signed by both principals. Both instructions bind each principal to the terms of the agreement. Both the escrow instructions and purchase agreement are used to provide escrow with the specifics of the transfer.

If either principal wants to amend an aspect of the escrow instructions, both parties must consent. Any alteration is referred to as an **amendment to escrow instructions**. The escrow agent must be made aware of any changes immediately.

Should any aspect of either the escrow instructions or the purchase agreement be in conflict with one another, the most recent document generally supersedes the other. Therefore, as escrow instructions come after the purchase agreement, they typically take precedent. However, a purchase agreement may stipulate that in the event of such a conflict, the terms of the purchase agreement should supersede the terms of the escrow instructions.

To make escrow valid, both the buyer and seller must sign escrow instructions. According to the Department of Real Estate: "If only one principal has signed, that principal may terminate the proposed escrow at any time prior to the other principal's signing of conforming escrow instructions. As an additional principal, the lender(s) typically reserves the right to withdraw their instructions, instruments, funds, and related documents if the escrow instructions of the buyer and seller do not conform to the instructions of the lender(s)."

When both principals have signed escrow instructions, the escrow is perfected. The following are included in escrow instructions:

- Names of the buyer and seller
- Subject property's purchase price
- Transaction terms and contingencies
- Buyer's deposit

- Vital documentation, including:
  - Title insurer & preliminary title report
  - Beneficiary statement
  - Deed of reconveyance
- Structural reports and inspections
- Lender information
- Closing statements & costs
- Form of title transfer
- Audit
- Closing

## Buyer's Deposit

The first instruction in escrow instructions is typically for the buyer to put forward an initial **earnest deposit**. This deposit is a percentage of the purchase price for a subject property, and serves as a good faith indicator of the buyer's intent to purchase.

Escrow will hold the buyer's deposit in a trust account until the property title is released to the buyer. An agent must maintain the trust account with extreme care. Overdrawn accounts are strictly forbidden.

Escrow typically requires buyers and sellers to sign a cancellation agreement. In the event that escrow is terminated by either principal, the cancellation agreement will dictate the terms of the deposit and how payment will be refunded. However, as an escrow company's responsibility is to follow the instructions of the principals, it cannot refund a deposit until all parties have mutually agreed.

Should the buyer and seller disagree about who is entitled to the deposit, an escrow agent may initiate interpleader action in order to resolve which principal has valid claim to the deposit.

Civil Code 1057.3 states that any party involved in the purchase of a 1-4 unit building may be subject to a penalty if he or she refuses to execute the demands of the other party within the specified time period. The penalty for a principal who has not met his or her agreed-upon obligations is potentially losing his or her deposit and, if applicable, the cost of attorney fees.

## Preliminary Title Reports

Prior to any funds or documentation being received or distributed, an escrow agent will order a preliminary title report. A title company -- also known as a title insurer -- is responsible for issuing title insurance policies and the preliminary title report.

A title company will conduct a title search to thoroughly research public documents for any relevant information regarding a subject property. This includes all known liens/encumbrances, easements, and ownership in the property.

Many title searches uncover liens that must be addressed before a title insurer will issue a policy, or the buyer purchases the property. Buyers almost never purchase properties with junior liens, particularly when they are personal in nature. Typically, properties are only exchanged when personal liens and debt (minus a loan on the property) are removed from the transaction. (Liens will be discussed further in Chapter 11.)

A title company will then issue a **preliminary title report**. This “prelim” is not a policy; rather, it is a report that states which terms and conditions a title insurer is willing to offer in a policy.

Liens and encumbrances will be listed as “exceptions” on a title insurance policy and will not be covered. A title report also includes all current title agents, land records, and parties who claim to have an interest in the property.

If a non-principal party’s claim to escrow is within the chain of title, such claims must be satisfied by the escrow agent in order to obtain the title insurance coverage required by the principals (including lenders) (Department of Real Estate).

## **Beneficiary Statement**

A **beneficiary statement** is a written disclosure from a lender to a borrower that includes the loan balance, interest rate, terms, and conditions of the loan secured for the transaction.

The lender is required to supply the borrower with a beneficiary statement. The borrower has the right to receive one free statement per year. Additional requests for the statement cost money. Borrowers have the right to receive the statement within 21 days of their request. Should the lender not provide the statement within the 21 day period, the borrower is entitled to a \$300 credit towards their mortgage or a refund of \$300.

## **Deed of Reconveyance**

Unlike a deed of trust, which formalizes a borrower’s mortgage debt from a lender, a deed of reconveyance states that a borrower’s mortgage debt has been paid off. When a mortgage debt has been satisfied, a **deed of reconveyance** releases the title to the subject property back to the borrower. This verifies that the borrower is the sole legal owner of the property.

A deed of reconveyance must be provided by a lender within 30 days of a request.

### Case Review: *Pintor v. Ong (1989)*

The case, *Pintor v. Ong (1989)* 211 Cal.3d 837., involved a lender who refused to provide a borrower with a deed of reconveyance after the borrower paid off a loan.

A borrower (Pintor) paid off a loan to a lender (Ong). However, Ong refused to execute a full reconveyance. As a result, Pintor was prevented from refinancing because of the existence of Ong's lien. Pintor sued for emotional distress.

The Superior Court ruled in favor of Pintor on the grounds that the "underlying debt was in tort, rather than in contract" which meant that Pintor could recover for emotional distress. Ong appealed. He contended that damages stemming from a violation of the Business and Professions Code are contractual in nature and that Pintor could not recover emotional distress unless he brought forth evidence of substantial damages, in addition to emotional distress. The Court of Appeals disagreed and upheld the lower court's ruling on the basis that not being able to refinance one's property when one has the opportunity to do so as a result of a lender's negligence is grounds for emotional distress.

## Structural Reports and Inspections

Common reports and inspections -- including soil, mold, plumbing, and other specific reports that relate to the property -- should be included in the escrow instructions.

## Lender Information

Escrow instructions must include instructions from a lender on how to satisfy a loan and be signed by the buyer.

## Closing Statements & Costs

An escrow closing statement states all the fees and costs necessary to closing escrow.

Closing costs are the costs that either a buyer or seller are required to pay in addition to a property's purchase price. The costs associated with closing a real estate transaction vary based on the terms of a transaction, purchase price, location, and/or local customs. All fees and costs can be found in the escrow closing statement.

Typical fees include:

- Title fees
- Recording fees
- Agent commissions
- Property taxes
- Loan fees
- Escrow fees

### **Escrow Fees**

Escrow companies have the right to set the price for services provided. Escrow fees are dependent on the complexity of a transaction, the time and effort spent, and the costs incurred by the escrow company. Therefore, there are no standard escrow charges or fees and there is no formal measure dictating them.

Additional escrow fees may be incurred when agents must work with lenders on the transaction. Such lenders may include a seller's lender, junior lien agents, and the lender for a buyer's financing.

Both principals should agree on how much they are willing to pay in escrow fees before they look for an escrow agent. As it is against the law for a real estate agent/broker to require the use of a specific escrow company, principals have the right to research the most suitable escrow for their needs.

In California, it is standard procedure for the buyer and the seller to split the costs of escrow. However, they do have the ability to negotiate how much each principal is responsible to pay. In some real estate transactions, for example, a seller may have to undergo repairs as a contingency of the purchase. Thus, the seller may request that the buyer cover all escrow fees.

In the case of a refinance, a lender will almost always require the borrower to pay the escrow fees.

It is illegal for an escrow to discount one principal's fee in exchange for a referral or the promise of future business. Escrow must provide each principal with the same discounts and savings opportunities; however, escrow can split escrow fees differently for principals based on the principal's negotiations with one another.

### **Prorating**

**Prorating** is the process of distributing property expenses amongst principals at the close of escrow. Expenses that are typically prorated include: property taxes, deposits, HOA fees, rental income, interest, and insurance. Individual prorations can be negotiated between principals.

The purpose of proration is to make expenses more equitable between principals in accordance with the buyer and seller's respective periods of ownership. For example, if a transaction closes in the middle of the month, escrow may prorate the costs of the property taxes between the buyer and seller.

Proration is based on a 360-day calendar year and a 30-day month.

## Impound Account

An **impound account** is a type of escrow account managed by a lender for the purpose of collecting a borrower's property expenses, including property taxes, title insurance payments, and H.O.A. fees that are required to maintain property ownership.

Property expenses are expensive, especially if a borrower is expected to make large annual payments. Lenders use impound accounts to divide a borrower's annual payments (mortgage payments, taxes, insurance, H.O.A. fees, and others) into more manageable monthly payments. This increases the likelihood that a borrower will stay current on all payments and not be subject to foreclosure.

In California, it is illegal for lenders to require single family residence borrowers to have impound accounts, except in the following circumstances:

- A borrower has failed to make two consecutive tax payments
- The loan is a government-backed loan, such as a FHA or VA loan

Lenders may impose impound accounts on high risk borrowers, including those with low income, bad credit, or lower down payment borrowers to offset the risk of funding loans to lower income or less credit worthy applicants.

Lenders particularly require borrowers to have impound accounts for low down payment borrowers because such borrowers have "less skin in the game" or a lower stake in the property thereby reducing the borrower's incentive to make payments.

The California Civil Code states that a lender cannot require a borrower to pay more than the federal maximum, or to contribute more than is needed to pay off property expenses. A lender also may not create circumstances that force a borrower to fall behind on property expenses.

In the event that a lender miscalculates property expenses, it must refund the overpayment back to the borrower within 30 days.

It is a lender's responsibility to inform a borrower of the steps required to maintain an impound account. This includes providing accurate payment deadlines so that a borrower doesn't fall behind on property taxes or insurance payments.

Failure by a lender to adhere to the aforementioned standards may allow a borrower to bring legal suit against the lender and recover for damages.

## **Form of Title Transfer**

Any and all documents that signify ownership interest must be documented immediately. This may be a grant deed or trust deed/deed of trust.

An escrow agent must immediately forward any document that is to be recorded to the title company (or its underwritten title company agent, if other than the escrow agent). Copies are to be furnished to appropriate and concerned principals or third parties, so that the validity of the document can be determined.

This step helps to avoid a delay in completing and closing escrow.

## **Audit**

Before closing escrow, an escrow agent must hire a CPA to do an independent audit of all files. Escrow companies' files are subject to random inspection by the Department of Real Estate. These audits ensure that a company is not engaging in fraud, misrepresentation, inaccurate record keeping, or the mishandling of funds.

## **Closing**

The **closing** is the final step of a real property transaction prior to title being transferred from the seller to the buyer. This is where principals sign all closing statements and pay closing costs.

An escrow agent may not disburse any funds from an escrow account until all items -- such as checks, drafts, etc. -- have cleared and become available for withdrawal. This "holding period" may range from one to ten days depending on the type and location of the financial institution from which the checks are sourced.

## **Terminating Escrow**

The most common way to terminate escrow is by cancelling escrow instructions or the residential purchase agreement. However, while cancelling escrow instructions may terminate escrow, it does not terminate the purchase agreement.

## **Illegal Escrow Activities**

Should a licensed escrow agent engage in risky and potentially adverse activity that results, or could result, in the loss of a principal's money or property, the Real Estate Commissioner has the legal right to launch an investigation into the agent's activities. This may lead to suspension or revocation of his or her escrow license.

The Real Estate Commissioner's Regulation 2950 sets forth acts which are prohibited:

- (a) Soliciting or accepting an escrow instruction (or amended or supplemental escrow instruction) containing any blank to be filled in after signing or initialing of such escrow instruction (or amended or supplemental escrow instructions).
- (b) Permitting any person to make any addition to, deletion from, or alteration of an escrow instruction (or amended or supplemental escrow instruction) received by such licensee, unless such addition, deletion or alteration is signed or initialed by all persons who had signed or initialed such escrow instruction (or amended or supplemental escrow instruction) prior to such addition, deletion or alteration.
- (c) Failing to deliver at the time of execution of any escrow instruction or amended or supplemental escrow instruction a copy thereof to all persons executing the same.
- (d) Failing to maintain books, records and accounts in accordance with accepted principles of accounting and good business practice.
- (e) Failing to maintain the office, place of books, records, accounts, safes, files and papers relating to such escrows freely accessible and available for audit, inspection and examination by the commissioner.
- (f) Failing to deposit all money received as an escrow agent and as part of an escrow transaction in a bank, trust account, or escrow account on or before the close of the next full working day after receipt thereof.
- (g) Withdrawing or paying out any money deposited in such trustee account or escrow account without the written instruction of the party or parties paying the money into escrow.
- (h) Failing to advise all parties in writing if he has knowledge that any licensee acting as such in the transaction has any interest as a stockholder, officer, partner or owner of the agency holding the escrow.
- (i) Failing upon closing of an escrow transaction to render to each principal in the transaction a written statement of all receipts and disbursements together with the name of the person to whom any such disbursement is made.
- (j) Delivering or recording any instrument which purportedly transfers a party's title or

interest in or to real property without first obtaining the written consent of that party to the delivery or recording.

If a licensed escrow agent fails to report the necessary information as required by California real estate law within ten business days, the Commissioner has the ability to suspend or revoke the escrow agent's license (Business and Professions Code 17602.5).

### **Case Review: *Lee v. Escrow Consultants, Inc. (1989)***

In *Lee v. Escrow Consultants, Inc.* (1989) 210 Cal.3d 915., a buyer sued an escrow company for accepting a forged document.

A buyer (Monty Lee) entered into the escrow process with an escrow agent (Escrow Consultants, Inc.). At some point during the transaction, Escrow Consultants, Inc. accepted a forged escrow amendment. This led to the improper withdrawal of \$100,000 of Lee's deposited escrow funds. Lee sued.

The Superior Court ruled against Lee. Lee appealed. The appellate court ruled in Lee's favor, indicating that the escrow company had a duty to verify the signatures used to authorize the withdrawal of Lee's escrow funds.

### **Case Review: *Christenson v. Commonwealth Land Title Insurance Company (1983)***

In *Christenson v. Commonwealth Land Title Insurance Company* (1983) 666 P.2d 302., a principal sued a title company for providing inaccurate information regarding the liens and claims about a property.

A title company (Commonwealth Land Title Insurance Company) provided incorrect information to a buyer (Christenson) regarding a property he was purchasing. This inaccuracy resulted in a financial loss for Christenson. To recover losses, Christenson sued for negligent misrepresentation.

The Superior Court ruled in favor of Christenson. It contended that Commonwealth Land Title Insurance Company had provided information that Christenson relied on and assumed to be accurate, when in fact, it was not.

The fact that the title company acknowledged providing inaccurate data made them liable for Christenson's losses.

### **Case Review: *Summit Financial Holdings, Ltd. v. Continental Lawyers Title Co.* (2002)**

In *Summit Financial Holdings Ltd. v. Continental Lawyers Title Co.* (2002) 27 C.4<sup>th</sup> 705, involved a severe blunder of wrongful payment by an escrow company that ultimately took over 10 years to resolve.

A borrower, Dr. Furnish, secured a loan with his property in the amount of \$425,000 from Talbert Financial. During the loan process, Talbert Financial transferred the loan to Summit Financial Holdings without notifying Dr. Furnish. When Dr. Furnish refinanced his loan, another company (Continental Lawyers Title Co.) acted as his escrow agent. However, Continental Lawyers created escrow instructions that led to loan being paid to the original lender, Talbert Financial, rather than Summit Financial.

Once payment was transferred, Talbert Financial did not pay the loan proceeds to Summit Financial. Summit Financial sued Continental Lawyers to recover damages. Summit Financial contended that Continental Lawyers was responsible because they knew Talbert Financial had assigned its rights to Summit.

The case began in Superior Court, where judgment was awarded to Summit Financial. Continental Lawyers appealed. The Court of Appeals reversed the lower court's ruling, on the grounds that an escrow agent owes no duty of care to a nonparty to the escrow. Therefore, Continental Lawyers owed no duty of care to Summit Financial. The case was appealed again and heard in the California Supreme Court. The court upheld the appellate court's decision. Continental Lawyers were not held liable.

## **Title Insurance**

### **An Introduction**

**Title insurance** is indemnity insurance that protects a buyer in a real estate transaction from financial loss in the event that previously undisclosed title defects, encumbrances, or additional liens are discovered. Title insurance also protects a lender who is funding a loan for the purchase of a property.

Title insurance policies protect up to the maximum coverage amount. Once an insurance policy has been purchased, it is the title insurer's responsibility to pay the

costs of curing any defects, claiming legal action, or paying for the losses of the title agent.

Title companies engage in several steps prior to issuing an actual title insurance policy. (These steps do not ensure that a formal policy will be issued, however.)

As mentioned above, a preliminary title report exhibits all documents, claims, and/or legal actions currently affecting a property title.

A title company will also create an **abstract of title**. An abstract of title is a chain of title that provides a summarized history of all documents, claims, and legal actions affecting a property title, starting with the original grant deed. Unlike a preliminary report that simply provides ownership details of a specific parcel of land including liens and encumbrances, an abstract of title provides a more comprehensive history of property ownership of ownership transfers.

A **title plant** is a computer system which databases all title documents recorded in a county. Title insurers will navigate the title plant to verify the status of a property's title.

An **opinion of title** is an attorney's opinion regarding the condition of a property title, and a synopsis of the current ownership rights of interest agents.

Only when a title recording has been confirmed, closing costs are paid, and funds held in escrow are disbursed will a title insurance policy be created.

If a tax-defaulted property is purchased, a title company only offers title coverage after one year.

### **Case Review: *Harrison v. Commonwealth Land Title Ins. Co. (1979)***

The case, *Harrison v. Commonwealth Land Title Ins. Co. (1979) 97 Cal.3d 973.*, involved a dispute between a buyer and a title company regarding an undisclosed trust deed on a property.

When purchasing a property, a buyer (Harrison) used the services of a title company (Commonwealth Land Title Ins. Co.). After escrow closed, Harrison discovered that there was an undisclosed trust deed on his property. Commonwealth Land Title Ins. Co.'s coverage for Harrison's property included a maximum \$100 stated liability to the insured name. However, Harrison was not named an insured party on the final title report. Harrison brought legal action against Commonwealth Land Title Ins. Co.

The Superior Court contended that while Harrison had suffered financial loss, Harrison was not insured through Commonwealth Land Title Ins. Co.'s final title report. Therefore, even though Harrison had relied on the insurance company's information to purchase the property, he could not justifiably indicate that he had relied on their title report to make the purchase. Commonwealth Land Title Ins. Co. was not held liable.

### **Case Review: *Southland Title Corporation v. Superior Court* (1991)**

The case, *Southland Title Corporation v. Superior Court* (1991) 231 Cal.3d 530, involved a dispute between a buyer and a title company over an omission in the preliminary title report.

A buyer purchasing a property used the services of a title company (Southland Title Corporation). Southland Title Corporation issued a preliminary title report that did not indicate a flood control easement. The buyer bought the property. When the buyer discovered the easement, he brought legal action against Southland Title Corporation.

The Superior Court argued that the buyer had relied on the preliminary title report, rather than the final title report when he made the purchase. The court contended that a preliminary title report is not the full or final report of a property title, and that it may not include all necessary information. Therefore, it held that Southland Title Corporation was not liable for any damages resulting from the buyer's purchase.

## **Types of Title Insurance**

When a title company does decide to issue an official insurance policy, there are two main policy types:

- Homeowner's Coverage Policy
- Extended Lender Coverage Policy

### **Homeowner's Coverage Policy - Standard Coverage**

A standard coverage homeowner's policy protects buyers from title defects.

For example, if a lien is discovered on a buyer's property that affects his or her

ownership rights and/or makes the property title unmarketable, a homeowner's policy will cover the losses. A homeowner's policy will also cover losses resulting from a title defects that prevents a buyer from accessing his or her new property.

The maximum liability amount is generally the purchase price of the property. Specific coverages can be added to a policy depending on the requirements of the title and whether they agree to endorse the policy.

A standard coverage homeowner's policy includes:

- Tax liens
- Forgery
- Lack of capacity by the grantor to make effective decisions
- Previous deed that failed to be delivered
- Undisclosed spouse who claims a right to the property (typically divorce)

A standard coverage homeowner's policy excludes:

- Title defects not previously disclosed
- Tax claims that have not yet become tax liens
- Water rights
- Issues that would have arisen if the accurate steps had taken place
- Mining claims
- Zoning issues
- Undisclosed liens, such as personal liens
- Unrecorded deeds, existing leases
- Matters of the property that were not disclosed
- Government zoning, structure and building code failures

### **Homeowner's Coverage Policy - Extended Coverage**

Extended coverage insures risks beyond the scope of standard title insurance policy. It covers risks that were not known, or discovered, at the time a buyer purchased the property.

Extended coverage increases a policy by 10% for years 1-5, and will increase by up to 150% of the original coverage amount. An insurer will also pay the costs, attorney fees, and expenses incurred in the defense of any matter insured against by such a policy (to the extent provided in the conditions).

The **California Land Title Association (CLTA)** and the **American Land Title Association (ALTA)** are extended homeowner's coverage policies. The following are conditions included with the purchase of ALTA extended homeowner's insurance:

1. Title being vested other than as stated in Schedule A.

2. Any defect in or lien or encumbrance on the Title. This Covered Risk 2 includes but is not limited to insurance against loss from:
  - a. A defect in the Title caused by
    - i. forgery, fraud, undue influence, duress, incompetency, incapacity, or impersonation;
    - ii. failure of any person or Entity to have authorized a transfer or conveyance;
    - iii. a document affecting Title not properly created, executed, witnessed, sealed, acknowledged, notarized, or delivered;
    - iv. failure to perform those acts necessary to create a document by electronic means authorized by law;
    - v. a document executed under a falsified, expired, or otherwise invalid power of attorney;
    - vi. a document not properly filed, recorded, or indexed in the Public Records including failure to perform those acts by electronic means authorized by law; or
    - vii. a defective judicial or administrative proceeding.
  - b. The lien of real estate taxes or assessments imposed on the Title by a governmental authority due or payable, but unpaid.
  - c. Any encroachment, encumbrance, violation, variation, or adverse circumstance affecting the Title that would be disclosed by an accurate and complete land survey of the Land. The term "encroachment" includes encroachments of existing improvements located on the Land onto adjoining land, and encroachments onto the Land of existing improvements located on adjoining land.
3. Unmarketable Title.
4. No right of access to and from the Land.
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:
  - a. the occupancy, use, or enjoyment of the Land;
  - b. the character, dimensions, or location of any improvement erected on the Land;
  - c. the subdivision of land; or
  - d. environmental protection, 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.
6. An enforcement action based on the exercise of a governmental police power not covered by Covered Risk 5 if a notice of the enforcement action, describing any part of the Land, is recorded in the Public Records, but only to the extent of the enforcement referred to in that notice.

7. The exercise of the rights of eminent domain if a notice of the exercise, describing any part of the Land, is recorded in the Public Records.
8. Any taking by a governmental body that has occurred and is binding on the rights of a purchaser for value without Knowledge.
9. The invalidity or unenforceability of the lien of the Insured Mortgage upon the Title. This Covered Risk 9 includes but is not limited to insurance against loss from any of the following impairing the lien of the Insured Mortgage:
  - a. forgery, fraud, undue influence, duress, incompetency, incapacity, or impersonation;
  - b. failure of any person or Entity to have authorized a transfer or conveyance;
  - c. the Insured Mortgage not being properly created, executed, witnessed, sealed, acknowledged, notarized, or delivered;
  - d. failure to perform those acts necessary to create a document by electronic means authorized by law;
  - e. a document executed under a falsified, expired, or otherwise invalid power of attorney;
  - f. a document not properly filed, recorded, or indexed in the Public Records including failure to perform those acts by electronic means authorized by law; or
  - g. a defective judicial or administrative proceeding.
10. The lack of priority of the lien of the Insured Mortgage upon the Title over any other lien or encumbrance.
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.
  - b. over the lien of any assessments for street improvements under construction or completed at Date of Policy;
  - c. over any defect in or lien or encumbrance on the Title attaching or created before, on or after Date of Policy; as to each and every advance of proceeds of the loan secured by the Insured Mortgage, which at Date of Policy the Insured has made or is legally obligated to make; and
  - d. over any environmental protection lien that comes into existence before, on or after Date of Policy pursuant to any federal statute in effect at Date of Policy as to each and every advance of proceeds of the loan secured by the Insured Mortgage, which at Date of Policy the Insured has made or is legally

obligated to make.

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.
13. The failure of the Land:
  - a. to have the street address shown in Schedule A, and the failure of the map, if any, attached to this policy to show the correct location and dimensions of the Land according to the Public Record.
  - b. to be improved with a one-to-four family residential structure or, if stated in the description of the Land, a residential condominium unit.
  - c. to be zoned to permit a one-to-four family residential structure or, if stated in the description of the Land, a residential condominium unit.
  - d. to be a lawfully created one-to-four family residential parcel according to state statutes and local ordinances governing subdivision of land.
14. The forced removal, modification, or replacement of any existing one-to-four family residential structure or residential condominium unit located on the Land resulting from the violation of any of the following requirements of any applicable zoning ordinance: area or dimensions of the Land as a building site; floor space area of the structure; height of the structure; or distance of the structure from the boundary lines of the Land.
15. The assessment or taxation of the Land by governmental authority as part of a larger parcel.
16. The failure of the existing one-to-four family residential structure or residential condominium unit or a portion or a future modification or replacement to have been constructed with a valid building permit from the appropriate local government issuing office or agency.
17. The inability to use the existing one-to-four family residential structure or residential condominium unit or a portion of it or a future modification or replacement to it for one-to-four family residential purposes because that use violates a restriction shown in Schedule B.
18. Damage to improvements, lawns, shrubbery or trees constructed or planted on the Land before, on or after Date of Policy resulting from the future exercise of any right to use the surface of the Land for the extraction or development of minerals, water or any other substance.
19. The encroachment onto the Land of an improvement constructed after Date of Policy.
20. Encroachment of improvements constructed on the Land after Date of Policy onto adjoining property or over any easement or building setback line on the Land.
21. Forgery after Date of Policy of:
  - a. any instrument purporting to subordinate, assign, release, or reconvey the Insured Mortgage; and

- b. any instrument purporting to convey or encumber the Title.
- 22. The invalidity, unenforceability, or lack of priority of the lien of the Insured Mortgage as to Advances made or changes in the rate of interest charged subsequent to any modification of the terms of the Insured Mortgage made after Date of Policy which are secured by the terms of the Insured Mortgage as modified.
- 23. Damage to improvements, lawns, shrubbery, or trees constructed or planted on the Land before, on or after Date of Policy occasioned by the exercise of the right to use or maintain any easement referred to in Schedule B.
- 24. Interference with the use for one-to-four family residential purposes of the improvements constructed on the Land before, on or after Date of Policy occasioned by the exercise of the right to use or maintain any easement referred to in Schedule B.
- 25. Supplemental real estate taxes, including those caused by construction or a change of ownership or use, that occurred before Date of Policy, not previously assessed against the Land for any period before Date of Policy.
- 26. The invalidity or unenforceability of the lien of the Insured Mortgage upon the Title based upon a violation of the usury laws of the state where the Land is located if no other Mortgage is shown as an exception in Schedule B.
- 27. The invalidity, unenforceability, lack of priority, or avoidance of the lien of the Insured Mortgage upon the Title:
  - a. resulting from the avoidance in whole or in part, or from a court order providing an alternative remedy, of any transfer of all or any part of the title to or any interest in the Land occurring prior to the transaction creating the lien of the Insured Mortgage because that prior transfer constituted a fraudulent or preferential transfer under federal bankruptcy, state insolvency, or similar creditors' rights laws; or
  - b. because the Insured Mortgage constitutes a preferential transfer under federal bankruptcy, state insolvency, or similar creditors' rights laws by reason of the failure of its recording in the Public Records
    - i. to be timely, or
    - ii. to impart notice of its existence to a purchaser for value or to a judgment or lien creditor.
- 28. Any defect in or lien or encumbrance on the Title or other matter insured against by this policy that has been created or attached or has been filed or recorded in the Public Records subsequent to Date of Policy and prior to the recording of the Insured Mortgage in the Public Records. Unless stated to the contrary in Schedule B, the Company incorporates the following American Land Title Association (ALTA) endorsements into this policy by this reference as if these endorsements had been attached to this policy
  - a. ALTA Form 4-06 (Condominium), if a condominium unit is referred to in the description of the Land;
  - b. ALTA Form 5-06 (Planned Unit Development);

- c. ALTA Form 6-06 (Variable Rate Mortgage);
- d. ALTA Form 6.2-06 (Variable Rate Mortgage—Negative Amortization);
- e. ALTA Form 8.1-06 (Environmental Protection Lien) subject to the statutes, if any, shown in Schedule B specifically for this endorsement; and
- f. ALTA Form 9-06 (Restrictions, Encroachments, Minerals—Loan Policy).

### **Extended Lender's Coverage Policy**

In addition to the two main title insurance policies for homeowners, lenders may require **extended title insurance** before approving an applicant for a purchase loan. The purpose of extended lender insurance is to insure lenders in the event that undiscovered liens are placed on the property for which the loan was funded.

As the overwhelming majority of loans are sold on the secondary loan market, lender title insurance protects future lenders' interests as well.

An extended coverage lender's policy includes:

- Unrecorded liens or easements
- Water rights
- Mining claims
- Inability to access property
- Rights of parties who have possession of the property (generally includes tenants)
- Patent issues
- Undiscovered survey or lack of physical inspection

An extended coverage lender's policy excludes:

- Government regulations (generally zoning and coding issues)
- Matters already discovered by the insured, but not disclosed to the insurer
- Eminent domain
- Physical condition of property
- Violations of property borders

### **Special Policies**

Special policies are available for specific properties and situations. The availability of special title insurance programs is based on the state of the property. Special policies may cover:

- Mechanic's liens
- Construction liens
- Oil/gas interests

- Tenant claimant
- Sales contracts

### **Case Review: *Lick Mill Apartments v. Chicago Title Co.* (1991)**

In the case, *Lick Mill Apartments v. Chicago Title Co.* (1991) 231 Cal.3d 1654., a buyer sued a title company for failure to disclose a property's material facts.

A buyer (Lick Mill Apartments) had signed a purchase agreement for a property. During escrow, Lick Mill Apartments used the services of a title company (Chicago Title Co.) in order to protect its interests. Escrow closed and the property title was transferred. Later, the buyer discovered that there was hazardous waste on the property. Lick Mill Apartments sued Chicago Title Co. for not informing them of this prior to purchase and asked to be reimbursed for the costs to remove the hazardous waste.

The Superior Court reasoned that Chicago Title Co. was responsible for indicating the marketability of the property's title, not the property's conditions or defects. Therefore, the title company was only responsible for disclosing information related to hazardous waste if a related lien had been recorded. The court ruled Chicago Title Co. to be not liable.

### **Case Review: *Walter v. Marler* (1978)**

The case, *Walter v. Marler* (1978) 83 Cal.3d 1, involved a dispute between a buyer and a seller whose outcome was influenced by the buyer's title policy.

A buyer (Walter) purchased a piece of land from a seller (Marler) under the promise that a property would be constructed. Marler did build a property, but a large portion of the construction took place on land that was not included in the sale to Walter. This meant that Walter paid for the price of a property he did not receive. Walter held a standard homeowner's coverage policy that did not cover him for this specific situation. Consequently, he sued Marler, the title company, and his own brokers.

Initially, the Superior Court held Marler and the other defendants liable. The defendants appealed. The Court of Appeals reduced the liability placed on Marler and the other defendants, only holding them liable for the difference between the actual value and market value of the property Walter purchased, rather than the full market value. Had Walter purchased an extended

homeowner's coverage policy, however, the policy would have covered all of his losses.

## Rebate Law

**Rebate law** prohibits a title company or escrow company from receiving payment from a real estate professional as a referral of a client in need of title insurance or escrow services, respectively. Failure to abide by the laws regulating the title insurance industry may result in a penalty of up to one year in jail and/or a fine of up to \$10,000 (Penal Code 641.4).