TITLE INSURANCE:
Exclusions, Exceptions & Claims

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Introduction

This paper will focus on key provisions of the title insurance policy, including the determination and timing of loss; the duty to indemnify and defend the insured; and the impact of exceptions and exclusion 3(a) and 3(b) on the obligations of the insured under the contract. We will focus on how the courts in Texas have construed coverage in relation to these policy provisions.

Policy Terms

Who is insured?

Title insurance companies are liable to owners and lenders for actual losses suffered due to title defects covered by the policy. Schedule A sets forth the name of the insured under the American Land Title Association's policy forms. The title insurer owes a duty only to the named insured as defined under the policy. See Daca, Inc. v. Commonwealth Land Title Ins. Co., 822 S.W.2d 360 (Tex. Civ. App. --- Houston, 1992) (*held insurer has no duty to defend if the insured is not named as a party in a lawsuit*); See also Mapco, Inc. v. Carter, 817 S.W.2d 686, 687 (Tex. 1991). In Texas, two policies are generally issued by the title insurer.

T-1 Owner's Policy of Title Insurance

A purchaser is issued the standard Owner's Policy (Form T-1). See also Residential Owner Policy of Title Insurance - One-To-Four family Residences (Form T-1R). (TDI, *Basic Manual of Title Insurance*, Section IV, Procedural Rules P-1(bb) (2014). The general rule is an owner's policy must be written for the amount of the current sales price of the land, improvements, and any contemplated improvements. See Procedural Rule P-66(A)(1)(a). In the event there is no sale is involved, the policy may be written for the present fair market value of the land, including improvements only under specific circumstances as defined by the policy and the Texas Rule P-8 exceptions. The owner's policy continues as long as the named insured or their heirs own the land. See Procedural Rule P-66(A)(1)(b). It also may provide the insured with warrantor's coverage depending on the policy provisions.

This policy insures against loss, as of the date of the policy not to exceed the policy limits, sustained by the insured as a result of: (1) title being vested other than as stated in Schedule A of the policy; (2) any defect in or lien or encumbrance on the title; (3) Lack of good and indefeasible title; and (4) no right of access to and from the land. Under the standard Owner's Policy, the Conditions section 1(d) defines the term "insured" as follows:

> (d) "Insured": the Insured named in Schedule A.
> (i) The term "Insured" also includes:
> (A) successors to the Title of the Insured by operation of law as distinguished from purchase, including heirs, devisees, survivors, personal representatives or next of kin;
> (B) successors to an Insured by dissolution, merger, consolidation, distribution or reorganization;
> (C) successors to an Insured by its conversion to another kind of Entity;
> (D) a grantee of an Insured under a deed delivered without payment of actual valuable consideration conveying the Title
> (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,
> (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, or
> (4) If the grantee is a trustee or beneficiary of a trust created by a written instrument established by the Insured named in Schedule A for estate planning purposes.
> (ii) With regard to (A), (B), (C) and (D) reserving, however, all rights and defenses as to any successor that the Company would have had against any predecessor Insured.

The "insured" includes not only the named insured, but also anyone who succeeds to the insured's interest by operation of law. This may include heirs, devisees, executors of the insured's estate, administrators, trustee who receives the insured property via a trust for estate planning purposes and corporate successors. Upon transfer of title, the policy may warrant title to the transferee and provide coverage if

the transferee has brought a title action. Southwest Title Ins. v. Plemons, 554 S.W.2d 734 (Tex. Civ. App. --- Dallas, 1977); Wolff v. Commercial Standard Ins. Co., 345 S.W.2d 565 (Tex. Civ. App.--- Houston, 1961). Otherwise, a purchaser of the insured's interest is not a successor by operation of law and may not make a claim since the owner's policy may not be assigned to purchasers of the property. See also Chicago Title Ins. Co. v. 100 Inv. Ltd. P'ship, 355 F.3d 759, 761-66 (4th Cir. 2004); Willow Ridge Ltd. Partnership v. Stewart Title Guaranty Co., 706 F. Supp. 477 (S.D. Miss. 1988); Keys v Chi Tile Ins. Co., 2012 U.S. Dist. LEXIS 140047 (S.D. Miss. 012)(not for publication).

T-2 Loan Policy of Title Insurance

A loan policy is specifically designed to insure the validity, enforceability, and priority of the lien of a mortgage, a deed of trust, or an assignment thereof subject. The Texas forms of loan policy (form T-2 and Short Form Loan Title Policy Form T-2R) are promulgated by the Department of Insurance. See *Basic Manual of Title Insurance*, Section IV, Procedural Rules P-1(ee)(2014).) The general rule is the loan policy must be written for the original amount of the loan. See Procedural Rule P-66(B)(1). The policy may be written for the amount of the value of the land or amount of the loan, whichever is less, where the land covered in the policy represents only part of the security of the loan. See Procedural Rule P-66(B)(2). Other conditions which may affect the amount of insurance include:

- When the land covered in the policy represents only part of the security of the loan(s), the loan policy shall be written in the amount of the value of said land or the amount of the loan, whichever is lesser.
- A loan policy may be issued in an amount equal to the original principal amount of the indebtedness plus legal interest not to exceed 25% of the principal amount.
- When a loan policy is issued for construction, the P-8 exceptions must be used.

See Procedural Rule P-66(B). Under the terms of the standard loan policy (Form T-2 and the Short Form Loan Title Policy), the owner of the indebtedness secured by the insured deed of trust and any successors and/or assigns is the insured and may make a claim. Thus, the loan policy extends coverage to purchasers of the loan as well as successors by merger, consolidation, reorganization or merger to another entity of the named insured. Under the standard loan policy, the Conditions section 1(e) defines the term "insured" as follows:

> (e) 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) if the Indebtedness is evidenced by a "transferable record," the person or Entity who has "control" of the "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:
> (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.

Upon the request of the insured, Texas Procedural Rule (P-7) does allow additional language describing the name of the insured in the case of a loan policy as follows: "and each successor in ownership of the indebtedness secured by the insured mortgage, except a successor who is an obligor under the provisions of Section 12(c) of the Conditions." This language may not be modified by additional language or by an endorsement nor may it be added to an Owner's Policy or a loan policy on interim construction. The loan policy typically terminates when the loan is paid off or the lien expires upon a valid foreclosure of the

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