



TITLE INSURANCE 101 BACK TO THE FUNDAMENTAL PRINCIPLES

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The Old Days

In the late-eighteenth and early nineteenth centuries, attorneys began hiring abstractors to perform title work. Abstractors would compile a history of the land, sometimes from the original land patent forward. (A land patent is a land grant or deed from a sovereign entity. In Illinois the examiner will sometimes see a land patent from the United States of America for a section of land or more.) These abstractors would then issue this compiled history, together with an abstractor's certificate. The certificate would inform the proposed purchaser and the attorney as to the matters purported to be covered by the abstract.

Abstracts have not been used in the Chicago area for many years. Until a few years ago, though, they were occasionally prepared in the central and southern parts of the state.

But relying on an abstract had its disadvantages. Consider the case of *Watson v. Muirhead*, 57 Pa. 161 (1868). Watson wanted to buy some property in Philadelphia. He hired Muirhead to abstract the public records. Muirhead discovered an unsatisfied judgment. Relying on a previous opinion from a local lawyer who felt that the judgment was not final and that

therefore did not affect the land, Muirhead omitted the judgment from his report.

After Watson purchased the land, the judgment creditor successfully enforced his judgment, and Watson lost the property at a judicial sale. Watson sued Muirhead for his damages. The court ruled, however, that Muirhead had exercised due care and therefore decided that Muirhead should not be held liable for an error that was not due to his negligence.

It was clear that something better was needed.

The Origins of Title Insurance

The first title company was organized in Philadelphia in 1876, just five years after the Great Chicago Fire of 1871. (It is a common misconception that Chicago Title Insurance Company was in existence during the Great Chicago Fire and that the company was able to save its real estate tract books from the fire. This is not the case. Rather, it was the employees of several abstract companies that saved these books. Chicago Title later acquired the tract books.)



The Title Insurance Commitment & Policy

Title Insurance is a type of insurance that protects real estate purchasers and mortgage lenders from certain title risks and adverse interests. The title company provides this insurance by issuing owner's title policies and loan title policies. The production of these title policies is a two-step process in which the title company issues both a title insurance commitment and a title insurance policy.

The Title Commitment

A title commitment is just as the name suggests—it is a commitment, a binding agreement, to issue a title insurance policy, insuring the land legally described in Schedule A of the commitment, subject to those matters set forth in Schedule B of the commitment, the Conditions of the commitment, and the terms of the form of title policy to be issued.

The title commitment obligates the title company to issue a policy at closing; thus, the commitment is an enforceable receipt for coverage; Illinois courts have allowed an insured to sue on a commitment if there is reliance on the commitment.

For example: in *W.E. Erickson Const., Inc., v. Chicago Title Insurance Company*, 266 Ill.App.3d 905, 641 N.E.2d 861, 204 Ill. Dec. 431

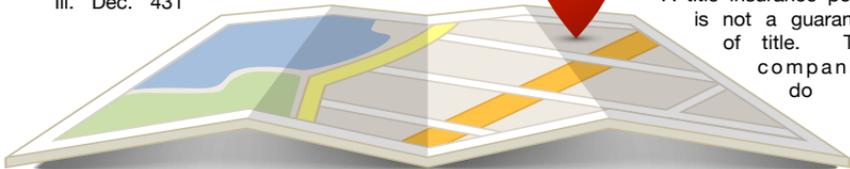
(1st Dist. 1994), a purchaser ordered a title policy two days after it obtained a deed to the land. Before the policy was issued, though, the Army Corps of Engineers notified the proposed insured that it claimed title to the land. The title company canceled the commitment when given notice of the claim, stating that the purchaser had not relied on the commitment. The Illinois appellate court agreed, saying that the lack of reliance was a bar to damages.

In other words, if the title company issues a title commitment but makes an error, and there is reliance on the title commitment, the title company may have liability. The fact that the title company did not issue a formal title policy may not necessarily make a difference.

The Title Policy

A title policy is a contract of indemnity. That is, it is a contract whereby the title company agrees to insure the insured against loss under the policy. The title insurance company, in exchange for a premium, agrees to pay the insured for loss or damage it suffers because of undisclosed liens or other matters that affect the property as of the date of the policy. The title company's monetary exposure for loss is limited to the face amount of the policy.

A title insurance policy is not a guarantee of title. Title companies do not





guarantee that title is as stated in the title policy. Rather, as previously indicated, title companies insure against loss.

The title policy also includes the duty to defend the insured against any lawsuit that attacks the insured's title, so long as the lawsuit is based on a title defect that the title company insured against.

The coverage of the title policy is not unlimited. As described below, the title policy coverage is subject to the exceptions shown in Schedule B, the policy's Exclusions, and the policy's Conditions.

The Nature of Title Insurance

Recall that abstractor Muirhead was not liable because he was not negligent. An abstractor's liability requires a showing of negligence. In contrast, a title insurer's liability in Illinois is based entirely on contract law. Negligence is not part of the title insurance equation in Illinois. Instead, an insured under a title policy must show that the insured suffered a loss by reason of a matter that was within the scope of coverage under the policy.

The nature of title insurance in Illinois is made clear in the landmark Illinois Supreme Court title insurance case, *First Midwest Bank v. Stewart Title Guaranty Co.*, 218 Ill.2d 326 (2006). The Court relied on an amicus brief submitted by the American Land Title Association (ALTA) and stated:

ALTA further explains, however, that it is not the purpose of a title commitment to provide a listing of all defects, liens and encumbrances affecting the property. A title

commitment is simply a promise to insure a particular state of title. To the extent that the title commitment contains information concerning the title, such information is provided to give notice of the limitations to the risk that the title insurer is willing to insure. . . .

The nature of title insurance in Illinois was also made clear in a subsequent appellate court decision, *United Community Bank and James T. McDonough v. Prairie State Bank & Trust and Santarelli and Sons, Inc.*, 2012 IL App (4th) 110973:

The buyer was not entitled to rely on the title commitment for information regarding the title, because the purpose of the title commitment was not to provide information regarding the title; rather, the title commitment had a wholly different, contractual purpose, namely, specifying the losses the title insurer was excluding from coverage in its offer to provide insurance.

The Owner's Title Policy Coverage



The owner's policy insures against loss or damage that the insured may sustain by reason of ten so-called Covered Risks.

Thus, the title policy reads as follows:

Subject to the Exclusions from Coverage, the Exceptions from Coverage contained in Schedule B, and the Conditions, Chicago Title Insurance Company insures . . . against loss or damage, not exceeding the Amount of Insurance,



sustained or incurred by the Insured by reason of (these Covered Risks).

Examples of Covered Risks

- **Any Defect in or Lien or Encumbrance on the Title—Covered Risk #2**

Covered Risk #2 is a Covered Risk that is very broad, containing many sub-paragraphs. (One of these sub-paragraphs appears below.)

The Company performs a title search to determine what matters affect the land. Examiners show those items in Schedule B as Exceptions from Coverage. But if the examiner misses something, and the missed item causes a loss to the insured, then the Company may have a claim. Why? It is due to this Covered Risk.



B of the title policy. An obvious example is a missed mortgage. But there are many others, such as missed easements, judgments, and mechanics lien claims.

- **The Failure of a Person or Entity to Authorize a Conveyance—Covered Risk #2(a)(ii)**

To avoid liability under this Covered Risk, the title company will, prior to or at closing, review partnership agreements, limited liability company operating agreements, and corporate documents in order to verify the identity of personnel authorized to execute deeds, mortgages, and other instruments on behalf of a business entity.

- **Lack of Access—Covered Risk #4**

The title policy insures against loss if the insured does not have legal access to the land.

Read the language of the policy again:

Subject to the Exclusions from Coverage, the Exceptions from Coverage contained in Schedule B, and the Conditions, Chicago Title Insurance Company insures . . . against loss or damage, not exceeding the Amount of Insurance, sustained or incurred by the Insured by reason of (these Covered Risks).

The Company insures against loss due to a defect in or lien or encumbrance on the title that does not appear in Schedule

Exclusions from Coverage

Again, see the policy:

Subject to the Exclusions from Coverage, the Exceptions from Coverage contained in Schedule B, and the Conditions, Chicago Title Insurance Company insures . . . against loss or damage, not exceeding the Amount of Insurance, sustained or incurred by the Insured by reason of (these Covered Risks).

In other words, the Company will insure



against loss under the Covered Risks, but this insurance is subject to the Exclusions from Coverage—matters that the Company does not cover in its insurance policy.

So what are the Exclusions from Coverage? The owner's policy includes five numbered paragraphs of Exclusions, with many lettered subparagraphs. Two of the most common Exclusions are set forth in paragraph 3—paragraph 3(a) and paragraph 3(d):

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

(a) created, suffered, assumed, or agreed to by the Insured Claimant;

(d) attaching or created subsequent to Date of Policy.

The meaning of Exclusion 3(d) is obvious. Under Exclusion 3(a), however, there are many cases construing the terms “created,” “suffered,” “assumed,” and “agreed to.”

Generally speaking, laws, ordinances, and governmental regulations are excluded from title policy coverage pursuant to Exclusion #1. (See below.) This Exclusion, however, must be read together with Covered Risk #5, which reads as follows

The violation or enforcement of any law, ordinance, permit, or governmental regulation [is covered by the policy] 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.

Exclusion #1 reads as follows:

1. (a) Any law, ordinance, permit, or governmental regulation (including those relating to building and zoning) restricting, regulating, prohibiting, or relating to
(i) the occupancy, use, or enjoyment of the Land;
(ii) the character, dimensions, or location of any improvement erected on the Land;
(iii) the subdivision of land; or
(iv) environmental protection;
or the effect of any violation of these laws, ordinances, or governmental regulations. This Exclusion 1(a) does not modify or limit the coverage provided under Covered Risk 5.

(b) Any governmental police power. This Exclusion 1(b) does not modify or limit the coverage provided under Covered Risk 6.

Coverage thus depends on what, if anything, appears in the public records.

Exceptions from Coverage

Again, see the language of the policy:

Subject to the Exclusions from Coverage, the Exceptions from Coverage contained in Schedule B, and the Conditions, Chicago Title Insurance Company insures . . . against loss or damage, not exceeding the Amount of Insurance, sustained or incurred by the Insured by reason of (these Covered Risks).



As previously noted, the title policy will include policy exceptions. These exceptions are what the title searcher finds in a title search. These exceptions might include such matters as utility easements, unpaid taxes, and unreleased mortgages.

The Conditions

The owner's policy is subject to pages of "terms and conditions." These are called the "Conditions" in the ALTA 2006 owner's policy. These conditions include such esoteric topics as "proof of loss" and the "duty of insured claimant to cooperate."

The Loan Policy Coverage

A loan policy insures the lender in the same manner as described above. But the loan policy contains fourteen Covered Risks, not just ten. The additional Covered Risks relate to the lien of the insured mortgage.

The Ninth Covered Risk

For example, the ninth Covered Risk concerns insurance against loss due to "the invalidity or unenforceability of the lien of the Insured Mortgage upon the Title."

This ninth Covered Risk has seven sub-paragraphs that further describe this insurance against loss. For example, Covered Risk 9(c) insures against loss in the event the insured mortgage was not "properly created, executed, witnessed, sealed, acknowledged, notarized, or delivered."

The Tenth Covered Risk

The tenth loan policy Covered Risk

concerns insurance against loss as to the lack of priority of the Insured Mortgage. This is probably the most important Covered Risk for a lender. The lender wants to know that its mortgage is, as much as possible, a prior lien, a first lien, subject to those matters shown in Schedule B.

Conclusion

Title insurance policies contain many more items of coverage and exclusion than those discussed in this brief article. Readers are encouraged to review the ALTA 2006 owner and loan policy forms to understand the full scope of title insurance. Chicago Title staff will be happy to assist.

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