TITLE INSURANCE COVERAGE FOR “UNMARKETABILITY OF TITLE”

John C. Murray
Vice President-Special Counsel
National Commercial Services

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By John C. Murray
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The ALTA title policy coverage for "unmarketability of title" pertains only to those unmarketability claims resulting from title defects; unmarketability problems relating to the use of the property are not ordinarily covered by the title policy. For example, off-record environmental contamination is not a risk covered by the insuring provisions of the standard title insurance policy. Such contamination is not a "defect, lien or encumbrance," and is not a matter affecting marketability of title.

There need not be an "adverse claimant" in order to raise an unmarketability claim. The mere possibility of a "cloud" on title, sufficient to justify a potential buyer or lender in declining to buy or lend on the property, is enough to trigger coverage under the policy.

Unmarketability of title is not necessarily the same as reduction in market value. The insured may suffer a loss, when selling or mortgaging a property as a result of a title defect that was not discovered or disclosed in the original title search, that can't be adequately measured by (as stated in the owner's policy for calculation of loss) "the difference between the value of the insured estate or interest as insured and the value of the insured estate or interest subject to the defect." If the buyer refuses to purchase the property because the seller is unable to deliver title in the condition specified in the purchase agreement, the loss to the insured triggered by the sale of the property may be different than a loss otherwise incurred by the insured after the closing.

"Perfect title" may be defined as title "without fault, defect or omission." Providing coverage against loss by reason of reason of unmarketability of title is different from that of certifying that the owner or the mortgagor "in fact" or "in law" is possessed of a marketable title. See, e.g., Crown Enterprises, Inc. v. Trustco Bank N.A., 2001 NY Slip Op. 400779U, 2001 N.Y. Misc. LEXIS 452 (Sup. Ct. of N.Y., Rensselaer Co., July 16, 2001) ("a title company's unconditional approval to insure a particular title does not necessarily render that title marketable," citing 12 Warren's Weed New York Real Property, 4th Ed.).

Essentially, title is "unmarketable" if an "alleged" or "apparent" matter would permit a purchaser who has contracted to buy the real estate to cancel on grounds of unmarketability. Exactly what constitutes a marketable title is a matter of judicial interpretation. State courts have varying definitions of this term. For example, courts have defined marketable title as "free from reasonable doubt," "free from defects and encumbrances," "title a reasonable [or prudent] person would accept," "not a perfect title but one which is not subject to reasonable doubt nor does it require litigation," "title that may be freely made the subject of resale and that can be sold at a fair price to a reasonable purchaser or mortgaged to a person of reasonable prudence as security for the
loan of money," "one that is relatively free from doubt, such that in a suit for specific performance a court would compel the prospective purchaser to accept title," and title that is "free from reasonable doubt and such as reasonably well informed and intelligent purchasers, exercising ordinary business caution, would be willing to accept." However, at least one case, Stewart Title Guaranty Co. v. Greenlands Realty, L.L.C., 58 F.Supp. 2d 360 (D. N.J. 1999), has held that title is not rendered unmarketable by an alleged defect that is not reasonably debatable or by the threat of litigation that has "no reasonable justification."

In Mellinger v. TICOR Title Insurance Co., 13 Cal. Rptr. 357 (Cal. App. 2001) [the subject of a DIRT discussion last year], the court stated that "Based on the meaning of marketable title established by the Supreme Court, the question is whether a reasonable purchaser, knowing that a third party might claim an interest in the property, would nonetheless proceed with the transaction." The court held that whether an encroachment was evidenced in the real property records was a question of fact for the jury, and refused to concur with an Illinois decision that treated the issue as a question of law. (The court acknowledged that the policy's survey exception might later be found to be applicable to exclude coverage, but stated that it was first appropriate to decide whether coverage existed in the first place under the terms of the policy).

In a loan policy, this insuring proviso ("Unmarketability of the Title") covers the lender against title-related claims that actually disable or prevent the lender from selling his or her (or its) mortgage to another investor, or would require the lender to repurchase a mortgage. As noted above, this language does not cover circumstances resulting from physical condition of the land, such as contamination with hazardous waste or damage to improvements.

The parties to a real estate transaction (as well as title insurers) should understand that there is a difference between marketable and insured title. See, e.g., Patten of New York Corp. v. Geoffrion, 598 N.Y.S.2d 355, 356 (A.D.3 Dept. 1993), appeal denied, 82 N.Y.2d 654 (1993) (holding that an easement created no material defect to the title, and therefore did not destroy marketability; because the title insurer was unwilling to insure the easement, the easement prevented the title from qualifying as insurable, even though it had no impact on the marketability of title); Nelson v. Anderson, 286 Ill.App.3d 706, 7008-09, 676 N.E.2d 735, 736 (5th Dist. 1997) (finding that the existence of an encroachment rendered the title "unmerchantable," which the court defined as "that which a reasonable person will accept as not subject to a doubt or cloud that would affect its market value," and that the availability of title insurance to provide coverage over the risk would not prevent the purchaser from refusing to close for failure to deliver merchantable title).

Although the ALTA title policy forms define the term "public records" (in Section 1(f) of the Conditions and Stipulations) the policy does not limit its coverage to matters of record title only. However, it does limit the title company's obligation for searching to the public records as defined in the policy.
What if the defect is not of record, but could have been identified if a survey had been done and submitted to the title insurer? Since the policy does not limit coverage to record matters, the title insurer must either take a general survey exception, or examine the survey and take specific exception to the items shown on the survey. If the title insurer takes specific exceptions for items shown on the survey, but misses a matter that should have been excepted and does not show it as a specific exception (such as an encroachment), the title insurer should be liable if the buyer repudiates the contract and refuses to close because it has discovered the defect and refuses to close the transaction.