▶ CONSUMER LAW

An Introduction to Title Insurance, Liability and Damages

By Edward L. Robinson

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Title insurance has become a fundamental part of most real estate transactions, both commercial and residential. Sellers, buyers and lenders rely on it to ensure items of record are disclosed, to ensure the buyer is receiving proper title to the property, and to provide coverage if items are missed or competing claims of ownership arise.

A full discussion of title insurance in Kansas could probably fill a book. As a result, this article is intended as an introduction to title insurance in Kansas, how title insurers can be liable if they fail to discharge their duties and obligations, and some of the damages available in such cases.

A Brief Background and History of Title and Title Insurance

The fundamental reasons for title insurance are as old as land ownership itself. In every real estate transaction, a buyer wants to receive valuable title to the land and know the restrictions or encumbrances on the land before closing. The means and methods of assuring this have changed over time and evolved to what we have today.

Federal, state and local restrictions, along with easements for utilities and adjacent landowners, take away some of the absolute right of property ownership. As a result, real estate buyers generally bargain for "marketable" title.

In Kansas, marketable title was originally defined as "one which appeared from the records of the county to be good and free from all incumbrances."[1] Numerous court decisions have expounded upon what constitutes an "incumbrance."

For the practitioner, it should be noted that Kansas' definition and treatment of marketable title is dramatically different from some other jurisdictions, so careful attention must be paid before relying on any authority outside Kansas.[2]

In order to put others on notice of claims of ownership to real property, it was (and is) common for each county to have a central repository for recording such documents. In Kansas, each county has a Register of Deeds responsible for recording and maintaining these documents.[3]

For centuries, prospective buyers used attorneys to search these records and pass on the title to the property before closing. In Kansas this was called an "abstract" or "abstract of title." This system worked well, but not perfectly, and these imperfections eventually changed how title searches were performed and buyers were protected.

This shift began in Pennsylvania in the 1860s following the case of *Watson v. Muirhead*.[4] Watson, the buyer, hired Muirhead, a conveyancer,[5] to determine whether a parcel was free of encumbrances.[6] Muirhead had learned of a judgment lien on the property but, based on another attorney's statement that the judgment lien did not bind the property, Muirhead did not disclose its existence to Watson.[7] Watson bought the land but lost it shortly thereafter when the sheriff seized and sold the land to satisfy the lien.[8] Watson sued Muirhead for negligence, claiming Muirhead should have

disclosed his knowledge of the judgment lien.[9] Affirming a defense verdict in favor of Muirhead, the Pennsylvania Supreme Court ruled he was not necessarily negligent in relying on the other attorney's statements, and that "an attorney ought not to be liable in case of a reasonable doubt."[10]

The response to the decision in *Watson* gave birth to the title insurance industry. In 1874, the Pennsylvania legislature enacted a law allowing corporations to examine and search titles.[11] Kansas followed suit in 1923.[12]

Today, title insurance companies are an integral part of real estate transactions in Kansas. They are commonly used for issuing title commitments and title insurance policies, and real estate closings routinely occur in their offices. Aside from oil and gas transactions, attorneys are no longer commonly used for abstracts or title opinions.

Basic Title Insurance Mechanics and Procedure

The typical real estate transaction involves a title company issuing a "title commitment" after a real estate contract has been signed, but before closing.[13] The title company receives the purchase contract and then reviews the recorded documents affecting the real property at issue. It then issues a written commitment, which is its promise or agreement to cause a title insurance policy to be issued (by itself or through an underwriter) if the requirements of the commitment are fulfilled.

The title commitment has three main parts. The first is the "Requirements" section. It lists every issue that must be satisfied before the title insurance policy will be issued, such as paying the premium, recording all necessary documents such as mortgage releases to divest the current owner of ownership, and eliminating any known title issues such as judgment liens.

The second part is the "Exceptions from Coverage" section. It lists all the matters that will not be covered, which generally encompasses any matter not of public record and all recorded documents listed in the commitment. The third part is the "Conditions" section, which has liability limitations and other matters.

If all the prerequisites of the title commitment are met, the title company or its underwriter will issue a title insurance policy consistent with the title commitment. The coverage limit of the insurance is generally the purchase price of the property. The title insurance policy will insure against various "Covered Risks," including unmarketable title; not insure against any item listed in the "Exclusions from Coverage;" and have many other conditions and details for making claims under the policy.

The title company that issues the title commitment will not necessarily be the company that issues the title insurance policy. For example, a local title company may issue the title commitment, but a regional or national underwriter may issue the title insurance policy. Knowing if these companies are the same or different is critical to understanding liability and damages in title cases.

Title companies do not always perform a full search of the recorded documents in preparing a title commitment. For example, if a title company had previously issued a title commitment for a certain parcel of land and that same land is being sold again, the title company may only look to see if there are any new recorded documents since the previous title commitment was issued, and assume the previous title work was correct. If the previous commitment happens to be wrong, there are potential issues of liability.

Title companies also do not always perform a full search of the recorded documents for a particular legal description. For example, a buyer contracts to purchase 15 acres of land, and a title commitment is issued for that legal description. Before closing, the buyer decides he only wants 10 of those acres, with no new land outside the original metes and bounds.

Under those circumstances, a title company may not conduct a new search of the recorded documents, but must rely on the information disclosed in the original commitment. This practice is known as "down dating," and does not necessarily raise issues of liability if the original commitment was correct.

Liability and Damages of Title Companies and Underwriters

Title claims commonly arise when a property buyer learns of an issue affecting his property that he did not know about when he purchased it. When these situations arise, there are two possible avenues: breach of contract and negligence.

Breach of Contract

A breach of contract action arises if a valid claim is made for coverage under the title insurance policy and that claim is denied. If the issue with the property falls under one of the "Covered Risks" and is not otherwise excluded, coverage should exist up to the policy limits. In these cases, the claim is against the company that issued the title insurance policy, not necessarily the title company.

An example of such a case is if the title to the property is unmarketable because of some condition on the property. Kansas has well-developed case law on what makes a title marketable. According to the Kansas Supreme Court, a marketable title is

> [O]ne which is free from reasonable doubt; and under this rule a title is doubtful and therefore unmarketable if it exposes the party holding it to the hazard of litigation.[14]

More specifically:

> The defect of title of which the purchaser complains must be of a substantial character; one from which he may suffer injury. Mere immaterial defects which do not diminish in quantity, quality, or value the property contracted for, constitute no ground upon which he may reject the title. Facts must be known at the time which fairly raise a reasonable doubt as to the title; a mere possibility or conjecture that such a state of facts may be developed at some future time is not sufficient.[15]

Put in simpler terms, a purchaser of land, expecting to receive marketable title,

> can simply require a title such as prudent men, well advised as to the facts and their legal bearings, would be willing to accept. The doubts must be such as will affect the market value of the estate. They must not be made up for the occasion, based on captious, frivolous, and astute niceties; they must be such as would induce a prudent man to hesitate in accepting a title affected by them.[16]

Examples of unmarketable title are existing violations of ordinances;[17] construction of improvements that encroach upon setback lines;[18] and easements that substantially reduce property value.[19] Kansas' treatment of marketable title should not be confused with several other states, which limit marketable title to competing interests of ownership.[20]

A level below marketable title is another potential issue: land whose title is marketable but has a "defect, lien or encumbrance" on the property. In other words, title to land may be marketable but have a defect, lien or encumbrance that triggers coverage.[21]

If the title insurer denies a valid claim, the property owner/insured may recover damages up to the limits of the policy, along with attorney fees pursuant to the fee-shifting statutes for direct actions against insurers.[22] The types of damages available would be limited to those ordinarily recoverable for breach of contract.

Negligence

A negligence action arises if the title company breaches a duty of care in preparing the title commitment and causes damage to the property owner. Although attorneys are not as involved as they used to be in researching titles and issuing opinions, their legal duty as abstractor or conveyancer is imposed upon the title companies that perform such work.

In *Ford v. Guaranty Abstract & Title Company*[23] the Kansas Supreme Court stated:

> Where a title insurer presents a buyer with both a preliminary title report and a policy of title insurance two distinct responsibilities are assumed; in rendering the first service, the insurer serves as an abstractor of title and must list all matters of public record regarding the subject property in its preliminary report. When a title insurer breaches its duty to abstract title accurately it may be liable in tort for all the damages proximately caused by such breach.[24]

If a property owner has a claim against the title company for failing to find and disclose a document or information that causes damages, he may have a claim for negligence against the title company even if the claim would otherwise be excluded from coverage by the title insurance policy.

Such a claim would not be subject to the policy limits of the insurance or the fee-shifting provisions of Kansas law for actions against insurers.[25] The damages would include those ordinarily recoverable for negligence, although in Kansas the starting point for such damages is the cost of giving the buyer the benefit of his bargain.[26]

If the same company prepared the Title Commitment and Title Insurance Policies, the property owner/insured may have to elect his remedy.[27] Such an election may not be required if the companies are different.

Conclusion

Title insurance has become ubiquitous in most real estate transactions, with the vast majority of these transactions closing without incident. However, when a transaction goes awry, it is important to understand the role and duties of title companies and title insurers.

Understanding the basic function of title commitments and title insurance policies; Kansas' treatment of marketable title; and the dual liability for preparation of title commitments and issuance of title insurance policies provides a solid foundation for the practitioner handling such claims. ▲

ENDNOTES

1 *Durham v. Hadley*, 47 Kan. 73, 81-82, 27 P. 105 (1891).
2 *See* n.18, *infra*.
3 K.S.A. 58-2221.
4 57 Pa. 161, 1868 Pa. LEXIS 81.
5 A "conveyance" is "one whose business it is to prepare deeds, mortgages, examine titles to real estate, and perform other functions relating to the transfer of real property." BLACK'S LAW DICTIONARY 301 (5th ed. 1979).
6 *Id.* at *1.
7 *Id.* at *2-3.
8 *Id.* at *1.
9 *Id.*
10 *Id.* at 167.
11 Act of April 29, 1874, P.L. 84.
12 Art. 18 §17-1801 and Art. 20 §17-2002(7) R.S. of Kan. 1923; L.A. Pelkey, *The Law of Title Insurance*, 12 MARQUETTE L. REV. 38 (1927) (discussing when different states enacted similar statutes).
13 If the purchase contract is silent on whether marketable title will be conveyed, such a term may be implied as a matter of law. *Anderson v. Overland Park Credit Union*, 231 Kan. 97, 126, 643 P.2d 120 (1982).
14 *Scott v. Kirkham*, 165 Kan. 140, 145, 193 P.2d 185 (1948).
15 *Id.* at 146.
16 *Id.* at 147; *see also Peatling v. Baird*, 168 Kan. 528, 532, 213 P.2d 1015 (1950); *Lohmeyer v. Bower*, 170 Kan. 442, 452, 227 P.2d 102 (1951); *J & S Bldg. Co. v. Columbian Title & Trust Co.*, 1 Kan. App. 2d 228, 240, 563 P.2d 1086 (1977).
17 *Lohmeyer*, 170 Kan. at 453.
18 *Workman v. Shawnee Fed. Sav. & Loan Ass'n*, No. 61,447, 1988 Kan. App. LEXIS 431, at *5 (June 17, 1988).
19 *Hanna v. Hayes*, 1986 Kan. LEXIS 276, at *13.
20 *See, e.g., Haw River Land & Timber Co., Inc. v. Lawyers Title Ins. Corp.*, 152 F.3d 275, 278 (4th Cir. 1998) (Title refers to the legal ownership of a property interest so that one having title to a property interest can withstand the assertion of others claiming a right to that ownership. But title to property does not characterize the property itself as valuable, merchantable, or even usable"); *Bear Fritz Land Co. v. Kachemak Bay Title Agency, Inc.*, 920 P.2d 759, 762-63 (Alaska 1996) (noting that in Alaska title marketability relates "to defects affecting the legally recognized right and incidents of ownership").

Stewart Title Guar. Co. v. Greenlands Realty L.L.C., 58 F. Supp. 2d 370, 382 (D. N.J. 1999) (noting that "defect" is something less than "unmarketability," and "if 'defect' was synonymous with 'unmarketability,' there would be no reason for the policy to list both terms"); *see also Vestin Mortg., Inc. v. First Am. Title Ins. Co.*, 101 P.3d 398, 403 (Utah App. 2004) ("we also recognize that 'defect' may be defined as something less than a 'lien' or 'encumbrance.' The fact that [special improvement district] and notice did not amount to a 'defect,' 'lien,' or 'encumbrance,' does not mean that all three terms are given the same meaning.").

22 K.S.A. 40-256.

23 220 Kan. 244, 553 P.2d 254 (1976).

24 *Id.* at 266; *see also Bender v. Kan. Secured Title & Abstract Co., Inc.*, 34 Kan. App. 2d 399, 409-411, 119 P.3d 670 (2005); *Southwind Exploration, LLC v. St. Abstract Co., Inc.*, 2009 Kan. App. LEXIS 717, at *9-12 (June 22, 2009).

25 K.S.A. 40-256.

26 *Epp v. Hinton*, 91 Kan. 513, 138 P.576 (1914); *Hoffman v. Haug*, 242 Kan. 867, 872, 752 P.2d 124 (1988).

27 *Ford*, 220 Kan. at 258-59.

VOLUNTEER CHAIRS REQUESTED

It's time for changing of the guard... After many years of dedicated and effective service as Chair of the KsAJ Journal Board of Editors, Jim Howell has decided to move on to other leadership responsibilities in the Wichita area. Jim's contributions will be honored appropriately in the near future — please stay tuned!

Meanwhile, the search is on for those candidates who are interested in serving as the prestigious volunteer ***Chair of the KsAJ Journal Board of Editors.*** *Key points of the "job description" are shown below. If you would like to be considered, your letter of interest and CV should be sent to Emily Wilson by June 14, 2013: ewilson@ksaj.org or c/o KsAJ, 719 SW Van Buren, Ste. 222, Topeka, KS 66603.*

Focus: Volunteer Chair will assist with development of KsAJ's flagship publication, the Journal of the Kansas Association for Justice. This leadership role offers one the opportunity to showcase and grow his/her writing and analytical skills, as well as professional credentials, among jurists and litigators in the Kansas legal community.

- Candidates should have interest in writing and communicating with Kansas practitioners about key trends in Kansas law or notable cases. It is recommended that candidates have experience with law journal, legal review publications, or other journalistic endeavors. Candidates should be prepared to accept an initial commitment of at least 3-5 years, after which the term may be extended if mutually agreeable.
- The Journal is one of the key benefits of KsAJ membership and is recognized among the Kansas bar for its excellence. As such, the Chair is responsible for convening the Journal Board of Editors and directing the content of the publication to feature articles that educate and inform Kansas practitioners about issues affecting KsAJ members' practices.
- The KsAJ Journal is distributed to all KsAJ members, all Kansas Supreme Court justices, Appellate Court judges and District Court judges, as well as District Court Magistrates, work comp ALJs, and regional law libraries. The Journal is also circulated to each state TLA, which often gains inquiries/ requests for republication of Journal articles across the nation.
- Editor is largely supported by the Managing Editor (KsAJ Manager of Communications) to coordinate bimonthly production schedule, manage administrative tasks, provide continuous quality improvement (i.e. online format and planned design facelift) and finalize the editing and design of each publication.

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KsAJ owes a debt of thanks to retiring chair Derek S. Casey of Wichita. Derek has been active with the Amicus Curiae Committee since 1992 and has served as its Chair since 2009. In 2012, he moved to the firm of Triplett, Woolf & Garretson and has resigned as Chair of the Amicus Committee so that he has more time and energy to focus on his new workload and career direction. KsAJ's leadership will be honoring Derek for his service — more details to come.

For those interested in serving as ***Chair of the KsAJ Amicus Curiae Committee,*** *key points in the "job description" are shown here. To be considered, your letter of interest and CV should be sent to Charlotte Krebs by June 14, 2013: ckrebs@ksaj.org or c/o KsAJ, 719 SW Van Buren, Ste. 222, Topeka, KS 66603.*

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- This is a volunteer position with no compensation. The primary benefit of participation is the opportunity to hone brief writing skills. This service is greatly respected and appreciated by your colleagues within KsAJ. The cost to print, bind and ship the briefs is usually paid by the firm or attorney who prepares the brief.
- Although the committee has functioned largely without staff support from KsAJ headquarters, current staff is willing to provide support if it would be helpful to ensure seamless operations of the committee.