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Liability and Meaning of "Loss" in New York Title Insurance

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dle course, rewrites the rule, beclouds it by substituting appreciation of the criminality of conduct for knowledge of the nature of the act and its wrongfulness, and, thereby, also rejects the New York concept of "wrong" from a moral viewpoint.

The addition to the existing rule of a third branch to cover volitional impairment is the course recommended by the Royal Commission minority. Substantively, it follows the reasoning of *Parsons v. State*,[129] but is broader than "irresistible impulse," and was the test adopted by New Mexico in *State v. White*[130] in 1954:

> Assuming defendant's knowledge of the nature and quality of his act and his knowledge that the act is wrong, if, by reason of disease of the mind, defendant has been deprived of or lost the power of his will which would enable him to prevent himself from doing the act, then he cannot be found guilty.[131]

Radical solutions to a problem which will always be difficult, such as the abolition of legal guides to jurors, or the wholesale introduction of treatment in lieu of punishment, will result in chaotic and ineffectual administration of criminal law. It would seem preferable to draft an addition along the line advocated which would meet much of the valid criticism of the current New York statute, and yet retain the fundamental ethical concepts embodied in the basic rule.

LIABILITY AND MEANING OF "LOSS" IN NEW YORK TITLE INSURANCE

Introduction

Title insurance is today the predominant method of protecting title in many metropolitan areas.[1] Consequently, the nature of a policy of title insurance is of concern to all attorneys and particularly to attorneys practicing in the metropolitan areas.[2] The purpose of this article is to discuss the nature of this instrument. The area of particular emphasis will be the liability placed upon the insurer. This will lead to a better understanding of the rights and duties arising out of this particular insurer-insured relationship.

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129 81 Ala. 577, 2 So. 854 (1887).
130 58 N.M. 324, 270 P.2d 727 (1954).
131 *Id.* at —, 270 P.2d at 730.

1 PROCEEDING OF THE A.B.A. SECTION OF REAL PROPERTY, REPORT OF THE COMMITTEE ON ACCEPTABLE TITLE TO REAL PROPERTY, APP. A (1953).

2 Of the title insurance policies written in New York State in 1953, 91.5% were issued against property in metropolitan New York City. PRELIMINARY REPORT OF THE NEW YORK SUPERINTENDENT OF INSURANCE 40 (1955).

Origin of the Practice of Insuring Title

Prior to the practice of insuring title, a person's means of protecting himself from defects in his title were somewhat limited. One way was to seek an opinion from an attorney or a conveyancer [3] and to act according to the opinion rendered. However, if the buyer acted on an opinion that was later proved to be erroneous, the lawyer could only be held liable if he were shown to have been negligent in the formation of the opinion.[4] If the lawyer took reasonable precautions to investigate, the owner of the property had no recourse. This doctrine of determining liability was also held applicable to conveyancers.[5] An additional method of securing protection was to ask for covenants in the deed from the grantor. However, the protection afforded in a deed was of course dependent upon the continued solvency of the grantor. If the grantor of the property became insolvent, again, the owner was without recourse.

Recognizing this need and in satisfaction of it, the first title insurance company was formed in Philadelphia and received its franchise in 1876.[6] It was an additional protection, not dependent upon bad faith as were the common-law actions of negligence, fraud, deceit and the like. By spreading the risk of loss, the probability of the holder of defective title being made whole was also greatly increased.

Extent of the Liability of the Insurer

Title insurance is unique in that it is retrospective, not prospective.[7] It is designed to afford protection against past events, not possible future occurrences. By contracting to insure title, the insurer undertakes to indemnify the insured if the title turns out to be defective.[8] The sole object of title insurance is to cover possibilities of loss through defects that may cloud or invalidate titles.[9]

Due to the public nature of the services performed by title insurance companies, it is believed by many that these companies are public utilities, and as such, must insure every title that the courts declare marketable. Such is not the fact. The title insurance com-

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[3] A conveyancer is ". . . one whose business it is to draw deeds, bonds, mortgages, wills, writs or other legal papers, or to examine titles to real estate." BLACK, LAW DICTIONARY (4th ed. 1951).

[4] See Godefroy v. Dalton, 6 Bing. 460, 130 Eng. Rep. 1357 (C.P. 1830); Pitt v. Yalden, 4 Burr. 2060, 98 Eng. Rep. 74 (K.B. 1767).

[5] Watson v. Muirhead, 57 Pa. St. 161, 98 Am. Dec. 213 (1868).

[6] Rhodes, *Insurance of Real Estate Title*, 10 CONN. B.J. 206, 211 (1936).

[7] Trenton Potteries Co. v. Title Guarantee & Trust Co., 176 N.Y. 65, 72, 68 N.E. 132, 134 (1903).

[8] *Ibid.;* Palliser v. Title Ins. Co., 61 Misc. 490, 491-92, 115 N.Y. Supp. 545, 546 (Sup. Ct. 1908).

[9] Foehrenbach v. German-American Title & Trust Co., 217 Pa. 331, 66 Atl. 561, 563 (1907).

pany has a right to select its own risks.[10] Once the company does decide to insure, its liability extends to only those defects which are in existence at the time the insured acquires his interest if he is a purchaser (title guaranty)[11] or the date the policy is issued[12] if he is a present owner wishing to insure (owner's policy of title insurance). The basis for imposing liability is therefore found in this agreement which the parties form. This contract is construed liberally in favor of the insured and strictly as against the insurer.[13]

However, though it generally may be stated that this contract is to be the final measure of liability between the parties, this rule is somewhat modified by the doctrine of reformation. Under this doctrine, the petitioning party must show that there was a mutual mistake and the contract as evidenced by the instrument does not show the actual intent of the parties.[14] Because of the fact that these are contracts of adhesion,[15] the failure of the insured to read his contract is not generally considered such negligence on his part or laches to deprive him of the remedy of reformation.[16]

In addition to its liability under the policy, the company may be liable for negligence in performing the title search and examination. If the opinion the company renders is in error due to negligence in the search or in the analysis of the facts disclosed by the search, the company is liable provided the customer relied upon the opinion to his detriment.[17] This is similar to the general standard imposed upon attorneys.[18] Ordinarily under such circumstances, the customer will claim under the policy. It is possible at times that it might be more advantageous for him to bring the action in tort. For instance, if the damages resulting from the reliance were greater than the face

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[10] See Title Guarantee & Trust Co. v. Rudershausen, 164 N.Y. Supp. 15 (Sup. Ct. App. T. 1917).

[11] See Mayers v. Van Schaick, 268 N.Y. 320, 197 N.E. 296 (1935); Trenton Potteries Co. v. Title Guarantee & Trust Co., 176 N.Y. 65, 68 N.E. 132 (1903).

[12] See Empire Development Co. v. Title Guarantee & Trust Co., 225 N.Y. 53, 121 N.E. 468 (1918).

[13] See Broadway Realty Co. v. Lawyer's Title Ins. & Trust Co., 226 N.Y. 335, 337, 123 N.E. 754 (1919); First Nat'l Bank & Trust Co. v. New York Title Ins. Co., 171 Misc. 854, 857-58, 12 N.Y.S.2d 703, 709 (Sup. Ct. 1939).

[14] Empire Development Co. v. Title Guarantee & Trust Co., note 12 *supra;* Trenton Potteries Co. v. Title Guarantee & Trust Co., 176 N.Y. 65, 68 N.E. 132 (1903).

[15] A contract of adhesion is one where it is felt that the parties are not of equal bargaining power. See Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract,* 43 COLUM. L. REV. 629 (1943).

[16] See Lewitt v. Jewelers' Safety Fund Soc'y, 249 N.Y. 217, 164 N.E. 29 (1928). See also VANCE, INSURANCE § 44, at 258-59 (3d ed. 1951).

[17] Glyn v. Title Guarantee & Trust Co., 132 App. Div. 859, 117 N.Y. Supp. 424 (1st Dep't 1909). See also Ehmer v. Title Guarantee & Trust Co., 156 N.Y. 10, 50 N.E. 420 (1898); Dorr v. Massachusetts Title Ins. Co., 238 Mass. 490, 131 N.E. 191 (1921).

[18] Absent negligence, an attorney is not liable for an honest mistake of judgment. Gimbel v. Waldman, 193 Misc. 758, 84 N.Y.S.2d 888 (Sup. Ct. 1948); Dallas v. Fassnach, 42 N.Y.S.2d 415 (Sup. Ct. 1943).

amount of the policy, he could collect the full amount of his damages, thereby avoiding the limitation of the face amount of the policy.

Insurance companies may avoid the policy if they can show fraud on the part of the insured.[19] A standard clause in policies provides for this by stating that:

> Any untrue statement made by the insured . . . ; any untrue answer by the insured . . . to material inquiries before the issuing of this policy, shall void this policy.[20]

However, mere failure on the part of the insured to disclose any fact, though clearly material, will not avoid such a policy unless the non-disclosure was made with fraudulent intent.[21] If the fact is not one peculiar to his own knowledge,[22] the insured may assume that the insurer has acquired the information elsewhere and has no duty to speak.[23]

It would seem that a provision in the contract stating that the suppression of a material fact when the policy is obtained will void the policy would protect the insurer from liability arising from facts undiscovered by him but in the knowledge of the insured. However, it was stated in *Maggio v. Abstract Title and Mortgage Corporation*[24] that ". . . knowledge of defects in the title by the insured in no way lessens the liability of the insurer."[25] The courts seem to feel that the insurer must rely primarily upon the information acquired by its own methods of selection and to look to the applicant only for good faith.[26]

A further limitation is placed upon the extent of an insurer's liability if his policy contains a "coinsurance clause."[27] Under this clause, if the premises described in the contract are subsequently improved or altered in an amount exceeding twenty per cent of the

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[19] See Browning v. Home Ins. Co., 71 N.Y. 508 (1877) (per curiam); Vaughan v. United States Title Guarantee & Indemnity Co., 137 App. Div. 623, 122 N.Y. Supp. 393 (1st Dep't 1910).

[20] See City Title Ins. Co. policy No. 750 SF, Condition 5.

[21] Browning v. Home Ins. Co., note 19 *supra*.

[22] In a New York case, it was found that the insured withheld certain facts and should have disclosed them. First Nat'l Bank & Trust Co. v. New York Title Ins. Co., 171 Misc. 854, 12 N.Y.S.2d 703 (Sup. Ct. 1939). While at first appearing to contradict the above stated rule, the case merely states the exception to the rule. In this case the facts undisclosed were peculiarly in the possession of the insured. The facts in issue were certain credit statements affecting the realty which were in the possession of the plaintiff and unavailable to the defendant. We can see that in these circumstances, the court must impose a duty to speak since no matter what methods of acquiring information the insurer chooses, the information would not be available until the insured chose to release it.

[23] VANCE, INSURANCE § 61, at 375 (3d ed. 1951).

[24] 277 App. Div. 940, 98 N.Y.S.2d 899 (4th Dep't 1950) (mem. opinion).

[25] Maggio v. Abstract Title & Mortgage Corp., 277 App. Div. 940, 941, 98 N.Y.S.2d 1012, 1013 (4th Dep't 1950) (mem. opinion).

[26] VANCE, INSURANCE § 61, at 372 (3d ed. 1951).

[27] See City Title Ins. Co. policy No. 750 SF, Condition 12.

amount insured in the policy, the insurer will only be liable for that proportion which 120 per cent of the amount of the policy bears to the total value of the property as improved. This limitation can be removed by rewriting the contract to reflect the new value of the property. If this is not done, however, under the conditions stated in the coinsurance clause, the insured becomes a coinsurer.

Therefore, we may say that the standard for affixing liability will be the contract between the parties, modified by the doctrines of reformation and fraud and limited in amount by the face value and the coinsurance clause.

Nature and Purpose of the Title Insurance Contract

In addition to the main purpose of title insurance, that is, to indemnify a person whose title turns out to be defective, a policy holder receives another incidental benefit. Property covered by a contract of title insurance is thereby rendered more readily salable. By being able to present an insured title to the land to a prospective purchaser, the vendor will not be obliged to wait until the objections to title are cleared before the vendee will accept it. It makes land "liquid."

However, the main purpose remains, to indemnify from loss through defects in title to realty.[28] As has been demonstrated, the insurer's liability is determined according to the insurance contract into which he enters with the insured.[29] Many courts have therefore been called upon to describe the legal nature of this agreement. Various text writers have also defined this instrument which is the basis of the insurer-insured relationship.

At this point, we can move closer to an understanding of the nature of this relationship if we consider some of these definitions.

One writer has said that

> title insurance is an agreement whereby the insurer, for a valuable consideration, agrees to indemnify the insured in a specified amount against *loss* through defects in title to real estate wherein the latter has an interest, either as purchaser or otherwise.[30]

A contract of title insurance is also defined as ". . . a contract to indemnify against *loss* through defects in title to real estate or liens or incumbrances thereon." [31] New York courts have stated that the contract ". . . is one of insurance against defects in title, unmarket-

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[28] Trenton Potteries Co. v. Title Guarantee & Trust Co., 176 N.Y. 65, 72, 68 N.E. 132, 134 (1903); Palliser v. Title Ins. Co., 61 Misc. 490, 491-92, 115 N.Y. Supp. 545, 546 (Sup. Ct. 1908).

[29] See Holly Hotel v. Title Guarantee & Trust Co., 147 Misc. 861, 264 N.Y. Supp. 3 (Sup. Ct. 1932), *aff'd*, 239 App. Div. 773, 264 N.Y. Supp. 7 (1st Dep't 1933).

[30] FROST, GUARANTY INSURANCE § 162 (2d ed. 1909) (emphasis added).

[31] 1 COOLEY, INSURANCE 12 (2d ed. 1927) (emphasis added).

ability, liens and encumbrances . . . designed to save him harmless from *any loss* through defects, liens or encumbrances that may affect or burden his title." [32]

An analysis of these definitions reveals that the authorities are substantially in agreement as to the nature of the title insurance contract. The one cohesive element in them all is that all agree that the insured is to be kept free from *loss*.[33] This apparent point of agreement, however, is the very element upon which the courts have disagreed. The issue has been when does the insured suffer that type of loss for which the insurer is to be held liable under the contract for title insurance?

"Loss"—As Construed by the New York Courts

" 'Loss' is a relative term." [34] This is perhaps best illustrated by the fact that what is today the landmark case in New York on this point is a result of the reversal of the Appellate Division [35] by the Court of Appeals in the case of *Empire Development Co. v. Title Guarantee and Trust Co.*[36] In that case, the vendors agreed to assume and pay the assessments which had become liens at the time of the signing of the contract. However, they were not willing to pay any assessments which thereafter became liens. Accordingly, the contract provided that the purchaser, plaintiff in this litigation, should take title subject to all assessments that would subsequently arise. There was pending at that time a proceeding for opening a street which ran through the property. Before title was closed, assessments for this improvement were confirmed and became a lien on the property. Thereafter, the title was closed and plaintiff in this action paid the assessment as agreed in the contract of sale. The title insurance policy was in the usual form and contained a schedule which enumerated the liens, charges and incumbrances affecting said premises which the policy did not insure. In this schedule, no reference was made to the assessment here in issue which had become a lien before the policy was issued.

An examination of the holding in each appellate court will help to demonstrate the two basic theories or approaches to the problem of what constitutes loss.

In the Appellate Division, the term "loss" received a narrow construction. The court felt that the plaintiff was not seeking mere in-

[32] Trenton Potteries Co. v. Title Guarantee & Trust Co., 176 N.Y. 65, 72, 68 N.E. 132, 134 (1903) (emphasis added).

[33] See text at notes 29-31 *supra*.

[34] Foehrenbach v. German-American Title & Trust Co., 217 Pa. 331, 66 Atl. 561, 563 (1907).

[35] Empire Development Co. v. Title Guarantee & Trust Co., 171 App. Div. 116, 157 N.Y. Supp. 68 (1st Dep't 1917).

[36] Empire Development Co. v. Title Guarantee & Trust Co., 225 N.Y. 53, 121 N.E. 468 (1918).

demnification, but that a recovery would make the policy take on the form of a wagering contract. Their reasoning was that since the plaintiff already agreed to pay the money, he suffered no pecuniary loss and his recovery from the insurance company would not be a return to his status quo but would actually result in a profit on his part. The court said, "it [plaintiff] cannot be said to have been damaged by paying that which it had expressly agreed to pay in any event." [37] Further, ". . . it is very well settled in this state . . . that a policy of title insurance is essentially and solely a contract of indemnity and not a wagering policy." [38] From this it was reasoned that a plaintiff declaring on such a policy may only recover his actual loss. Since by the terms of the contract of sale the plaintiff would have been obliged to take title no matter how many assessments were later found to be liens on the property, ". . . the failure of defendant to discover . . . the assessment . . . imposed no burden upon the vendee that he had not already agreed to assume." [39] Therefore he had suffered no loss and judgment was rendered for the defendant.

The Court of Appeals felt that in the case of contracts for title insurance, recoverable loss should not be limited to only the precise amount of pecuniary damage caused the insured by the contingency against which he sought protection. They said that the contract of insurance specifically included just such a judgment as was rendered against plaintiff as a loss to be protected.[40] In spite of the fact that plaintiff had contracted with another to pay this sum, his paying the assessment was a "loss" nevertheless.

The Court of Appeals also felt that the parties themselves intended this interpretation of the contract. "The schedule of exceptions refers to a purchase-money mortgage executed by one of the plaintiffs; a reference not necessary if the construction given by the Appellate Division is to prevail." [41] If the defendants were to escape liability on the street assessment because plaintiff agreed to pay it, the court felt that they should similarly escape liability on the purchase-money mortgage, without excepting it, since plaintiffs also voluntarily undertook to pay it, just as they did with the street assessment.

The Court of Appeals therefore recognized that " 'loss' is a relative term" [42] and that the parties have a right to set the standard by which its existence or non-existence is to be determined. Once they found a loss as determined by this standard, set forth in the contract

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[37] Empire Development Co. v. Title Guarantee & Trust Co., 171 App. Div. 116, 119, 157 N.Y. Supp. 68, 70 (1st Dep't 1917).
[38] *Ibid.*
[39] Empire Development Co. v. Title Guarantee & Trust Co., 171 App. Div. 116, 120, 157 N.Y. Supp. 68, 70-71 (1st Dep't 1917).
[40] Empire Development Co. v. Title Guarantee & Trust Co., 225 N.Y. 53, 59, 121 N.E. 468, 470 (1918).
[41] *Id.* at 60, 121 N.E. at 470.
[42] Foehrenbach v. German-American Title & Trust Co., 217 Pa. 331, 66 Atl. 561, 563 (1907).

of insurance, the insured was entitled to compensation. Under this court's construction, the loss the plaintiff suffered was one that the defendants agreed to protect against. The case was reversed and remanded to the lower court to consider evidence on defendant's counterclaim for reformation, which had been erroneously dismissed in the court below.

Evaluation of the Court's Construction of Loss

Legally, "it must be borne in mind that the real subject of insurance is not the concrete thing, but the interest which the one to be indemnified has in the concrete thing." [43] The interest which the plaintiff in the *Empire* case wished to protect was the entire fee, less those exceptions specified in the contract. It was this interest which he submitted to the defendant company as the subject matter of insurance. The company was free to insure or not to insure as it saw fit.[44] Once it did insure, however, the estate or interest which was covered by the policy was that of fee simple less the stated exceptions. Any defect in title which reduced the insured's interest below that point was damage for which he was entitled to be indemnified. Legally then, we see that the decision of the court rested upon firm ground.

Although the necessity for a reversal by the Court of Appeals indicates that the intent of the parties was not eminently clear, the fact remains that the court chose to rely on the standard set by the parties or as the court construed their intent, rather than on some supplemental or arbitrary standard that would have no relation at all to the intent of the parties but would conform to a standard completely foreign to that intent.

It is also to be observed that the court may have adopted this more liberal construction of loss in view of the fact that the contract might be the subject of reformation.

Any rights of subrogation which the insurer might have are left intact by this decision. If the insured had notice of the defect, he has no right against his grantor concerning this defect. Therefore, since he never had this right, it cannot be said that he subsequently gave it up at the expense of the insurer. If the insured assumed the burden of the defect, again he never had a right under which the insurer had a right of subrogation. But if the insurer takes without notice, he will in most instances be protected from this defect in his deed. The insurer may then become subrogated under this right of the insured. The basic principle to be considered is that the insurer

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[43] *Ibid.*

[44] Title Guarantee & Trust Co. v. Rudershausen, 164 N.Y. Supp. 15 (Sup. Ct. App. T. 1917).

can only become subrogated to a right of the insured; if this right never arises, it can never be lost to the detriment of the insurer.[45]

The social argument most frequently advanced in favor of the *Empire* decision is the inequality of the parties. Substantially, the argument is this: To a layman a search is a mystery and the various pitfalls that beset his title are dreaded but unknown. To avoid a possible claim against his land he seeks professional advice. Once the professional has examined the risks and excepted those he finds undesirable, should not the layman be allowed to recover for any damage to his remaining interest? [46]

Basically, and in most cases, this argument has merit. However, it is suggested that where the insured knows of the defect and assumes it, seeking to recover for it later, a question of unjust enrichment on the part of the insured may arise. Unjust enrichment, as used here, refers to an obligation founded ". . . upon the fundamental principle of justice that no one ought to unjustly enrich himself at the expense of another." [47] This equitable principle established itself very gradually in the common law [48] until finally, under the influence of Lord Mansfield, the action was encouraged so widely that it became almost the universal remedy where a defendant had received money which he was obliged by the ties of natural justice and equity to refund.[49] In the usual case involving a policy of title insurance, the vendee who with knowledge assumed to pay an assessment has this reflected in the purchase price. It is submitted that to allow this person to recover from the insurer is violative of the fundamental principle of justice referred to above.

This argument based on the unequal positions of the parties is being further weakened by the fact that some companies now make it a practice to deal only with persons who are represented by counsel.

The interpretation of loss as presented by the Court of Appeals in the *Empire* case was followed in the recent case of *Glickman v. Home Title Guaranty Co.*[50] There, plaintiff's title was insured in fee simple by defendant insurance company. The policy contained the usual exceptions but failed to except certain accrued liens for sewer, grading, curbing and storm drain construction. Plaintiff in his contract of purchase had agreed with his vendor to assume the obligation for payment of the liens. Defendant contested liability under the policy on the theory that plaintiff had only done what he agreed to do and therefore suffered no loss. The court, relying on the *Empire* case, struck down the defense, holding that the policy was more than merely a contract for indemnification.

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[45] VANCE, INSURANCE § 134, at 787 (3d ed. 1951).
[46] 138 N.Y.L.J. No. 61, p. 12, col. 6, 7 (Sup. Ct. Sept. 25, 1957).
[47] Ames, *The History of Assumpsit*, 2 HARV. L. REV. 53, 64 (1888).
[48] *Id.* at 66.
[49] *Id.* at 68.
[50] 138 N.Y.L.J. No. 61, p. 12, col. 6 (Sup. Ct. Sept. 25, 1957).

It is interesting to note that the policy in the *Glickman* case contained a clause which provided that "no claim for damages shall arise or be maintainable under this policy . . . for liability voluntarily assumed by the insured in settling any claim or suit without the consent of this company." [51] At this time, this clause has not been raised as a possible means of avoiding liability. If it is raised, the defense may possibly fail due to the practice of construing the policies strictly against the insurer. The clause refers to the "insured" and if a time element can be introduced showing that plaintiff assumed before he became an "insured," the defense will fail. At any rate, contesting this clause would appear to be the next barrier the company can raise as a bar to recovery.

Conclusion

The *Empire* case has remained precedent for over forty years. The law therefore is well settled on the question of when a loss has been incurred under a contract for title insurance. While the broader construction of the term "loss" is adverse to the interests of the title insurers, it does not appear that the title insurers are taking any action as far as changing the form of their policies to include a possible catch-all condition. Rather they would appear to be adopting a policy of learning by previous mistakes. If the company is ordered to pay after litigating a claim, they must try to be more careful and be on guard against such exclusions in their future policies.

The argument of the defendant in the *Glickman* case attests to the fact that the insurance companies feel that the contract should be considered one of *strict* indemnity. That argument was practically a reiteration of the defendant's argument in the *Empire* case. Therefore, the insurers seem content to limit their efforts to sway the courts to their view of the contract as one of *strict* indemnity.

LIABILITY INSURANCE AND INTER-SPOUSE NEGLIGENCE ACTIONS: THE EFFECT OF SECTION 167(3) OF THE INSURANCE LAW

Recently a defendant in an automobile negligence action obtained a declaratory judgment requiring an insurance company to defend and pay any judgment rendered against him. The plaintiff in the original action was the wife of one of the defendant's employees. Her injuries were the result of her husband's negligent operation of a car

[51] See Home Title Guarantee Co., policy of title insurance, NYBTU Form No. 100 C, Condition 3(g).