UNDERWRITING DESKBOOK

Foreword

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Fidelity National Title Group, Inc.

December 2012

FOREWORD

PURPOSE OF THE UNDERWRITING DESKBOOK

This Deskbook is prepared exclusively for the use of the employees and agents of the Fidelity National Title Group, Inc. family of title insurance companies (“Company”) which includes Alamo Title Insurance, Chicago Title Insurance Company, Commonwealth Land Title Insurance Company and Fidelity National Title Insurance Company. It contains a series of monographs on a variety of underwriting subjects prepared by the members of the General Underwriting Department. This Deskbook is not a replacement for any applicable underwriting bulletins or directives issued by any of the Companies which may be more comprehensive, but is designed to be an easy reference for some common areas of concern.

CONFIDENTIALITY OF THE DESKBOOK

All materials contained in this Deskbook are confidential communications from the Company to you. Under no circumstances are the instructions or any other part of this Deskbook to be given or communicated to anyone who is not an employee or agent of the Company.

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Adverse Possession

As Basis for Insuring Over Encroachments

AFTER VERY CAREFUL CONSIDERATION, ADVERSE POSSESSION MAY BE USED AS THE BASIS FOR INSURING AGAINST LOSS ARISING FROM THE FORCED REMOVAL OF A BUILDING OR OTHER IMPROVEMENT LOCATED ON THE LAND WHICH ENCROACHES ON NON-GOVERNMENTALLY OWNED ADJOINING LAND, OR WHICH ENCROACHES UPON A NON-GOVERNMENTAL SURFACE EASEMENT IN USE OVER THE LAND. SPECIAL STATUTES OR PARTICULAR CIRCUMSTANCES MAY FORM THE BASIS FOR SUCH INSURANCE.

A final non-appealable judgment, as described in Section Adverse Possession 2, is necessary before we are willing to insure that the ownership of land occupied by an encroaching building has been acquired by the owner of that building. You should distinguish, however, the acquisition of the ownership of the land from the possible acquisition of the right to maintain the building in its present location for so long as the building exists. Under appropriate circumstances, you are authorized to extend this type of insurance, which is to be phrased to insure against loss or damage occasioned by the forced removal of the building. Note that this should not extend to loss or damage arising from the absence of the right to construct a new building to replace the existing building in the same location.

Insurance against forced removal may be possible in the absence of such a judgment in four circumstances.

- The first circumstance is where the encroachment is *de minimis*, usually considered to be less than an inch.
- The second circumstance is where the encroachment has existed for the required period for adverse possession.
- The third circumstance is where a special local statute protects a particular type of encroachment up to a given distance, usually in inches, in those jurisdictions wherein these statutes apply.
- The fourth is where you believe that unusual circumstances, such as might arise when the building has been erected with the encroachment known to the adjoining owner and without any complaint on part of that owner, would preclude the forced removal.
- **Review the Endorsement Manual Section 28 for further guidelines for issuing these coverages for encroachments.**

Adverse Possession
As a Basis for Ownership

DO NOT ISSUE A POLICY WHERE THE BASIS OF OWNERSHIP IS ADVERSE POSSESSION WITHOUT THE PRIOR APPROVAL OF THE COMPANY'S UNDERWRITING ADVISER UNLESS THE VESTING OF TITLE BY VIRTUE OF SUCH POSSESSION HAS BEEN JUDICIALLY DETERMINED.

Title through adverse possession is obtained by a person who is not the record or legal owner because the legal owner has failed to bring an action for ejectment of an adverse possessor within the time allowed by the law of the state where the Land is located. To qualify under this law, the adverse possession must be hostile and under claim of right, actual, open and notorious, and exclusive and continuous. All of these elements must be shown or proved.

In most instances, it is not possible to establish all of these facts through deed recitals, affidavits, etc. Consequently, a policy should not be issued where the ownership is based upon adverse possession unless there has first been obtained a final non-appealable court judgment based on credible evidence as to each of the above elements with all necessary proof of service on all parties whose interests are barred by the adverse possession.

Deviation from the foregoing rule is sometimes permitted in two Instances. The first instance is where the ownership to be insured is based upon a record chain of title for a period of time substantially longer than the required period for adverse possession and the adverse possession is intended to overcome an ancient "break" or defect in the chain of title.

The second instance is where the adverse possession relates to an outstanding strip or gore of modest dimensions which runs through a building on the land constructed at a date substantially prior to the beginning date required for the commencement of adverse possession. Even in these two instances, it may be necessary to limit the insurance to loss arising from actual or attempted eviction by inserting an appropriate exception as to the unmarketability of the title.

You are not authorized to determine whether the adverse possession being asserted fits within either of the foregoing circumstances but must submit the same to your Company underwriting advisor for approval.

In making your submission to your Company underwriting advisor, you should submit the following information:

1. Whether color of title exists, and if so, the nature of the color of title.

2. The nature of the facts which are alleged to sustain the asserted possession with relation to the type of possession, its duration, and the extent of the land affected by it, with emphasis on whether that part of the land affected was actually enclosed by a fence, wall or other such improvement.

3. Whether evidence exists which might show consent or permission for the possession, such as a written instrument, common map, etc.

4. Whether the owner to be barred by adverse possession is a government (state, local or federal) or a governmental body.

In making your decision you should consider the following information:

1. In the third circumstance referred to in Section Adverse Possession 1, the particular statute in question and information tending to show conformance therewith.

2. In the first, second and fourth circumstances referred to in Section Adverse Possession 1, which may be related to each other as to risk, the following:

   a. The extent of the encroachment;

b. The age of the improvement encroaching together with the applicable statute of limitations for adverse possession;

c. Whether the property or easement encroached upon is owned by a governmental entity; whether it is owned by a governmental entity in a proprietary as opposed to a governmental capacity; and if this makes the property or easement subject to adverse possession in the particular jurisdiction involved; and authority and information to support these facts;

d. If it is an easement that is encroached upon, whether the encroachment encroaches upon an easement in active use and upon a part of the easement which is in use and not, for example, simply over an underground utility easement; and the extent and type of use;

e. That there is no license agreement defeating the element of hostility required for adverse possession.

3. In all circumstances, the possibility, however remote, that the encroachment will be protested or any dispute that would impel removal of the encroachment.

Do not insure against forced removal of minor structures, such as fences, dividing walls, etc., which can be easily removed.

Note that we are only speaking of improvements on the Land to be insured encroaching on the land or easement of others, and not of encroachments from adjoining land upon the property to be insured. Encroachments from adjoining property onto the property to be insured must be excepted to, and no affirmative insurance is appropriate for them.

Adverse Possession

Exceptions

DURING THE COURSE OF A TITLE EXAMINATION, THE EXAMINER MAY ASCERTAIN CERTAIN INTERESTS ADVERSE TO THE RECORD TITLE HOLDER. BELOW ARE SET FORTH SUGGESTED REQUIREMENT LANGUAGE FOR SCHEDULE B, SECTION 1 OF A COMMITMENT

1. Where an adverse interest is disclosed by a recorded mortgage, financing statement or other document executed by a party not holding the record title, the following requirement should be raised in Schedule B, Section 1:

> *It appears that ___________, having no record interest in the Land, has executed a mortgage, (or deed of trust) dated ___________ and recorded ___________, as doc. ___________ in the public records of ___________ County, State, in the principal amount of ___________.*
>
> *Relative thereto the following is required:*
>
> *A. Deed from ___________ to the proposed Insured or party in title.*
>
> *B. Satisfaction or partial release of the mortgage referred to above to be placed of record.*

2. Where the examiner ascertains through some off record source that an adverse interest is being claimed in the property, the following requirement should be raised:

> *It appears that ___________ claims an interest in the Land by virtue of ___________. A quit claim deed should be obtained from ___________ to the party in title or to the proposed Insured.*

3. Where an adverse interest is disclosed by a deed from strangers to the title, a requirement in the form set forth below should be raised:

__________, having no record interest in the Land, conveyed the Land to __________ by deed recorded in Official Records, Book __________ at page _______ in the public records of __________ County, State.

Relative thereto the following is required:

A. Evidence should be furnished as to the former interest of __________ (grantor) and this commitment is subject to such further exceptions, if necessary, as will then be deemed necessary.

B. A deed from __________ (grantee) to the party in title or proposed Insured.

[It is important that all parties named in the chain of title in the situations described in Item 3 should be searched for judgments.]

4. Where the original grantee in a chain of title described in the requirement above has conveyed to other persons, the requirement should be modified to state somewhat as follows:

__________ having no record interest in the Land, conveyed the Land to __________ by deed dated __________ and recorded on __________ in Official Records Book __________ at page _______ in the public records of __________ County, State. By mesne conveyances the interest, if any, of the above grantor in the land was ultimately acquired by __________.

Relative thereto the following is required:

A. Evidence should be furnished as to the former interest of __________ (grantor), and this commitment is subject to such further exceptions, if any, as may then be deemed necessary.

B. A deed from __________ whose interest was acquired by said mesne conveyances to the party in title or proposed Insured.

[It is important that all parties named in the chain of title in the situations described in Item 4 should be searched for judgments.]

5. Where the examination of title discloses that taxes have been assessed to or are being paid by a stranger to the title, the following requirement should be raised:

It appears that ad valorem taxes for the year ________ have been (assessed to __________) or (paid by __________) who does not appear to have any interest of record in the Land.

Relative thereto the following is required:

A. Satisfactory evidence must be furnished as to the interest of __________ in the lands, and this commitment is subject to such further exceptions as may then be deemed necessary.

B. A deed from __________ to the party in title or to the proposed Insured.

Affidavits

Reliance Upon

THE PRIMARY PURPOSE OF AN AFFIDAVIT IS TO ESTABLISH THAT CERTAIN FACTS EXIST. A SECONDARY PURPOSE IS TO PROVIDE A METHOD BY WHICH THESE FACTS MAY BE MADE A PART OF THE PUBLIC RECORDS. IF, HOWEVER, THE FACTS RECITED IN THE AFFIDAVIT DO NOT EXIST, IT HAS LITTLE VALUE. THERE ALSO ARE OTHER METHODS BY WHICH IMPORTANT FACTS CAN BE MADE A PART OF THE PUBLIC RECORDS, THE USE OF WHICH MAY BE PREFERABLE TO THE USE OF AN AFFIDAVIT.

There are many factual situations which are important in establishing ownership which do not appear in deeds, mortgages or judicial proceedings found in the public records. Examples are identity, marital status, death and heirship, the length and nature of the possession of land, the date when construction of improvements was commenced and the date when the construction was completed and who furnished labor and material for the construction. If these facts are not established by judicial proceedings, it is customary to rely on affidavits made by persons who claim to know these facts.

While some states have statutes which give special status to an affidavit, generally its only value, if the facts which it recites do not exist, is to serve as the basis for a lawsuit against the maker if damage results from reliance on the affidavit, or as the basis for criminal prosecution for perjury against the maker. Since these recourses are less than satisfactory, if you decide to accept and rely upon an affidavit, you should use your best judgment in determining whether the facts which it recites probably exist. Consider whether the facts recited appear to be logical and consistent with other facts known to exist. Consider also whether the person making the affidavit is in a position to know the facts and whether his financial interest is such as to impair his credibility. If we can sustain a substantial loss if the facts recited do not exist, consider whether corroborating affidavits can and should be procured from other persons.

Do not accept an affidavit which states a legal conclusion unless the affidavit also recites the facts which justify that conclusion. An affidavit, for example, which says that John Jones, Jr. is the sole heir at law of John Jones, deceased, is stating a legal conclusion. An affidavit which states that John Jones died survived by no widow or former wife and by no children, either natural or by adoption, or descendants of deceased children, either natural or by adoption, other than his son, John Jones, Jr., is a recitation of facts which may cause you to determine that John Jones Jr. is the sole heir at law of John Jones.

It is desirable to record any affidavit which contains facts essential to the title. Recording the affidavit preserves its existence and apprises subsequent examiners of the facts which, in turn, reduces the possibility that marketability objections will be raised. But, in the absence of special statute, recording an affidavit does **not** make it a part of the chain of title. Consequently, it may be preferable to reflect these facts by recitation in a deed which is to be recorded and will be part of the chain of title. If the facts are vital to the title and your state law is clear that a subsequent purchaser is not required to accept the affidavit so as to establish the facts and make the title marketable, you may not want to accept the affidavit even though you are satisfied that it correctly states the facts. The alternative is to require judicial proceedings which will establish the facts.

It is obvious that no hard and fast rules can be laid down as to when you should or should not accept an affidavit, but that your best judgment must be exercised. If you are in a state where affidavits have been given a special status by statute, follow the rules prescribed by statute but, if the effect of the statute is to deprive some person of an actual interest, discuss the constitutional aspects with your Company underwriting advisor before giving the affidavit greater credence than you would give in the absence of the statute.

ASSIGNMENT OF MORTGAGES

WHEN YOU ARE ASKED TO ISSUE ENDORSEMENTS TO EXISTING LOAN POLICIES INSURING THE ASSIGNEE OF A COMMERCIAL LOAN OR PORTFOLIO OF LOANS AND THE LENDER IS A NON-INSTITUTIONAL LENDER AND THE LOAN IS MORE THAN 1 YEAR OLD THE FOLLOWING GUIDELINES MUST BE FOLLOWED.

Please review the Endorsement Manual Section 10 for further discussion of these issues

You must be careful not to inadvertently give coverage when you did not search, disclose or charge accordingly. The ALTA forms for insuring assignments (the 10-06 and the 10.1-06) are NOT the equivalent of a complete date down of the policy. They are the preferred form to use since they do not cover all title issues that may occur after the original policy, but rather limit the coverages to the matters defined within the endorsement. Any requests to add the assignment of the Insured Mortgage to Schedule A without changing the effective date, reflecting all intervening title matters and charging accordingly, or use of any forms other than the ALTA forms must be approved by your Company underwriting advisor.

You must be alert to the risk that the loan or some of the loans in the portfolio will at some point prior to the assignment be or come to be in default. Our current underwriting guidelines for the issuance of an endorsement that insures the subsequent assignee of an Insured Mortgage require an estoppel statement from the borrower IF: the Land is other than a one-to-four family residential property, or the assignor is a non-institutional lender; AND, the Insured Mortgage is more than one year old. See Requirement below.

For insurance of assignments of any loans **known** to be non-performing, you should raise the Exception shown below, which addresses the possibility that the loan is so far past due as to be unenforceable, and excepts the consequences of other actions of the lender that may be raised as defenses to the foreclosure.

For large portfolios this may well be impractical for the assignor to obtain. Nonetheless, you should not insure the assignment unless you have something which addresses the current status of the debt. You should consult your Company underwriting advisor for guidance.

If approved by your Company underwriting advisor, the Exception below may be used if an estoppel certification is not available from the borrower. If the assignor offers an indemnity to cover these consequences, the question of reliance on such an indemnity is a Credit Underwriting issue and must be referred to your company underwriting advisor.

Requirement:

A written sworn statement by the record owner of the land, stating that the lien of the mortgages(s) is (are) still good and valid and, in all respects, free from all defenses, both in law and in equity, should be furnished to the Company. [See the attached sample “Affidavit and Estoppel Certification”. You may use any form that contains the same information and is appropriately notarized.]

Exception:

Consequences, if any, arising out of any inability to foreclose or delay in foreclosing the Insure Mortgage(s) based upon the expiration of any statute of limitations, or challenges raised to the priority or enforceability of the Insured Mortgage based upon the acts or conduct of the original or subsequent lender.

AFFIDAVIT AND ESTOPPEL CERTIFICATION

Company or Agent ____________________

Order No. ____________________

AFFIDAVIT AND ESTOPPEL CERTIFICATION

State of ____________________,

County of ____________________:

The undersigned, being first duly sworn, deposes and says the following:

I am:

the [title or office:] _________________of [company name:] ____________________, OR

[name] _____________, an individual,

the Borrower that made, executed, and delivered that certain deed of trust or mortgage ("Mortgage") in favor of ____________________, as the original beneficiary or mortgagee, dated ____________________, recorded in __________, in the land records of ____________________ County, ________.

This Affidavit and Estoppel Certification (Certification) is made to the best knowledge of the undersigned Borrower.

Based on information and belief, the Mortgage is a good and valid lien upon the property described therein (Property), and the Mortgage and the note or notes, indebtedness and other obligations secured by the Mortgage (Obligations) are in all respects free from all defenses, in law and in equity.

This Certification is made for the protection and benefit of the current owner and holder of the Obligations secured by the Mortgage, and all other parties that may acquire an interest in the Property, and particularly for the benefit of any title insurer that insures the title to the Property directly or indirectly in reliance on the facts and representations contained in this Certification.

______________________(Borrower)

By:______________________________

OR

____
(Borrower, individually)

SUBSCRIBED AND SWORN TO before me this ____ day of ____________________, 20___.

Notary Public for ____________________

My commission expires: ____________________

Bankruptcy

General

IF A FEDERAL BANKRUPTCY COURT HAS, AT ANY TIME, ACQUIRED JURISDICTION OVER THE OWNER OF THE LAND INVOLVED IN OUR TRANSACTION, THIS JURISDICTION MAY AFFECT A SALE OR A MORTGAGE OF THE LAND. IT IS THEREFORE NECESSARY TO DETERMINE WHETHER A BANKRUPTCY COURT HAS OR EVER HAD JURISDICTION OVER THE PRESENT OWNER OR ANY PRIOR OWNER.

Bankruptcy law allows parties to obtain relief from their financial problems. The primary source of substantive bankruptcy law is the Bankruptcy Code (the Code), which can be found in Title 11 of the Unites States Code as amended. The Code is supplemented by the Federal Rules of Bankruptcy Procedure (F.R.B.P.) and Official Bankruptcy Forms promulgated by the United States Supreme Court as well as local rules established by various courts which govern the procedural aspects of bankruptcy cases. The Bankruptcy Reform Act (the Reform Act), was signed into law on October 22, 1994. Most of the changes addressed therein are applicable to cases filed after that date. Additional changes were made to the Bankruptcy Code which affect cases commenced on or after October 17, 2005 and December 1, 2009.

The progression of events in the ordinary bankruptcy case is: stay actions against the debtor, collect the bankrupt's assets, require creditors to file claims or be forever barred, allow or disallow claims that are filed, adjudicate preferences and fraudulent transfers, and make pro rata distributions of assets to creditors who will thereafter be barred by the discharge from taking further action against the debtor.

Applicable Law

While the Bankruptcy Code supersedes state statutes as to bankruptcy matters, state law may be applicable for purposes of addressing certain title concerns regarding real property as well as issues relating to a bankruptcy exemption's effect on the debtor's property. For example, New York substituted its own exemption for the federal exemption by adopting Article 10A of the Debtor and Creditor Law. An individual debtor must choose between state law exemptions or the federal exemptions contained in the Bankruptcy Code.

Administrative Proceeding

Bankruptcy courts are units of the Federal District Courts and are located in each Federal Judicial District. The processing of a bankruptcy case is considered primarily an administrative procedure whereby the trustee is afforded freedom to act without court supervision. Bankruptcy judges exist for purposes of resolving disputes and authorizing certain actions of the trustee.

Jurisdiction of the Bankruptcy Court – Core Matters

The jurisdiction of a bankruptcy judge is limited to processing core matters. [28 U.S.C. § 157]

Examples of core matters include:

- Orders to turn over property of the estate
- Proceedings to determine, avoid or recover preferences
- Motions to terminate, amend or modify automatic stays
- Proceedings to determine, avoid or recover fraudulent conveyances
- Determination of the validity, extent or priority of liens
- Confirmation of plans
- Orders approving the sale of property other than property resulting from claims brought by the estate against persons who have not filed claims against the estate.

The bankruptcy judge shall determine either on his own motion or on the timely motion of a party whether the proceeding is a core proceeding. In most cases where title insurance is involved, the orders issued by the court will arise out of a core matter.

Sovereign Immunity

The Code was intended to abrogate in certain instances and waive in others the sovereign immunity of governmental units including the Eleventh Amendment - immunity of the states from suits in federal courts [11 U.S.C. § 106]. However, a United States Supreme Court decision entitled *Seminole Tribe of*

Florida v. Florida, 116 S. Ct. 1114 (1996) concluded that the United States Constitution does not empower Congress to abrogate the states Eleventh Amendment immunity rights. In situations where a state's rights or the rights of a governmental unit of a state are to be affected by a bankruptcy proceeding, it is necessary to establish that a state or state agency was properly subject to an order of the bankruptcy court, and to ascertain that the state or its agencies have affirmatively waived their sovereign immunity rights, thereby subjecting themselves to the court's jurisdiction.

This may be accomplished by either:

A. State enactment of specific legislation or regulations addressing waivers of immunity, or

B. Affirmative action of the state or its agencies participating in or recognizing the specific bankruptcy proceeding, e.g., submitting or filing a proof of claim in a proceeding.

In the absence of the foregoing, a claim or interest of a state or its agencies in the debtor's property should not be disregarded in connection with a transaction arising through a bankruptcy proceeding.

Bankruptcy

Proceedings Available

PROCEEDINGS AVAILABLE UNDER THE BANKRUPTCY CODE ARE CHAPTER 7 – LIQUIDATION, CHAPTER 9 – ADJUSTMENT OF DEBTS OF A MUNICIPALITY, CHAPTER 11 – REORGANIZATION, INCLUDING RAILROAD REORGANIZATION, CHAPTER 12 – ADJUSTMENT OF DEBTS OF A FAMILY FARMER WITH REGULAR ANNUAL INCOME, AND CHAPTER 13 – ADJUSTMENTS OF DEBTS OF AN INDIVIDUAL WITH REGULAR INCOME. UNDER THE CODE, CASES ARE FILED UNDER ONE OF THE FIVE OPERATIVE CHAPTERS. CHAPTERS 1, 3, AND 5 APPLY GENERALLY TO CASES UNDER ANY OF THE OPERATIVE CHAPTERS OF THE CODE.

Commencement of Bankruptcy Cases

The filing of a petition begins the bankruptcy proceedings.

1) Voluntary Cases – The debtor commences the action by filing the petition which constitutes an order for relief. The filing in effect creates the estate administrated in the bankruptcy. It also results in an injunction staying collection actions as well as establishes a triggering date to determine which transfers of the debtor's property can be avoided. [11 U.S.C. §§ 301-302].

2) Involuntary Cases – Creditors of an entity begin the proceeding under Chapter 7 or 11 of the Code to allow for an equitable distribution of the debtors assets [11 U.S.C. § 303]. The court must make a ruling that the request for adjudication is justified. Notice to the debtor and a hearing is required. After an involuntary petition has been filed, a debtor may continue to operate its business until the court decides whether to issue an order for relief. Once a petition has been filed, all of the debtor's property becomes part of the bankruptcy estate.

Definitions

The Code provides a listing of definitions of bankruptcy terms [11 U.S.C. § 101]. For example, the party in bankruptcy is called the "debtor" and not the bankrupt in order to reduce the stigma associated with the latter term. In rehabilitation cases, the debtor does not surrender possession of assets and is referred to as the "Debtor in Possession." A trustee is a court officer who represents the estate in a bankruptcy proceeding and is authorized to take charge of property of the debtor for the benefit of creditors of the debtor. The trustee succeeds to rights of creditors as of the date that the case in bankruptcy was filed [11 U.S.C. § 544]. This is known as the "Strong Arm Provision" and among other things; it gives the trustee the rights of a hypothetical lien creditor to set aside certain pre-petition transfers including those which are voidable under state fraudulent conveyancing laws.

Bankruptcy Proceedings
Bankruptcy proceedings are referred to by the governing Chapter of the Code.

<u>Chapter 7 Proceedings</u> - Often referred to as liquidation proceedings where the debtors' non-exempt property is assembled by a trustee appointed by the court and then sold and the proceeds equitably distributed to creditors. If the debtor is a business, it ceases to operate once a Chapter 7 bankruptcy is filed unless otherwise ordered by the court. Generally, valid liens and encumbrances are not affected but the proceedings serve to discharge the debtor's personal obligation to pay many but not all debts. The debtor has no authority to deal with its non-exempt property.

<u>Chapter 11 Proceedings</u> – Referred to as reorganization proceedings. Usually no trustee is appointed. The debtor, which may include businesses as well as individuals, remains in possession of the property (debtor in possession) while attempting to work out a plan of reorganization of the business with its creditors. While in Chapter 11, certain activities of the debtor are regulated by the Code including the ability to use, sell or lease property outside of the ordinary course of business. The court can appoint a committee of creditors to monitor the debtor in possession.

Plans often provide for the disposition of real property, the mortgaging of real property or some other event affecting real property. Once the plan has been confirmed by the court and the appeal time has run, we can rely on the provisions of the plan which deal with real property for purposes of insuring the transaction. The order and the plan may be recorded if necessary for title purposes.

Once a plan of reorganization has been approved by the court, title to real property not dealt with in the plan revests in the debtor as its own real estate and the debtor is free to deal with that property as if the bankruptcy had not existed. This assumes that the property was listed in the schedule of assets.

Chapter 12 Proceedings – Adjustment of Debts of a Family Farmer with regular annual income – This chapter provides a procedure whereby family farmers are given an opportunity to reorganize their debt and, hopefully, to keep their land. A trustee will be appointed; however, the farmer as debtor remains in possession and may operate the farm. The trustee does not collect and liquidate assets as would be the case in a Chapter 7 proceedings.

The normal stay provisions apply. With respect to consumer debt, collection activities are stayed even against a party who may have guaranteed the debt of the debtor. This provision does not apply to debts other than consumer debts.

A family farmer is:

• An individual and spouse engaged in a farming operation where aggregate debt does not exceed $3,792,650 [11 U.S.C. § 101 (18) (A]);

• Not less than Fifty percent of the debt (exclusive of mortgages on a residential building) arises from the farming operations and;

• The individual and spouse receive more than fifty percent of their gross income from the family operation.

A mortgage debt on a residence is not excluded if it was incurred for farming operation purposes as distinguished from acquisition purposes. A corporation or partnership may be a family farmer where:

• Fifty percent or more of the stock is owned by a family which conducts the farming operation [11 U.S.C. § 101 (18)(B)];

• More than eighty percent of the value of the assets is related to the farming operation;

• The aggregate debt does not exceed $3, 792,650;

• Not less than fifty percent of the debt arises from the farming operation; and

• The stock is not publicly traded.

Chapter 13 Proceedings - Provides a procedure whereby individuals with a steady income can seek relief by debt adjustment over a 3 to 5 year period rather than by liquidation.

It allows a debtor who makes payment under a Chapter 13 plan to keep non-exempt assets which usually would be lost in Chapter 7 proceeding. A trustee is usually appointed.

Court Procedure
The Bankruptcy Rules provide that requests for judicial action in bankruptcy cases are typically made by motion. Unless made during the course of a proceeding, motions must be on notice to the debtor, trustee and others specified by rule [F.R.B.P. 9013] and served as specified by rule [F.R.B.P. 7004].

Certain motions affecting real property include those which:
- Seek relief from an automatic stay;
- Seek to avoid certain liens which encumber property or;
- Compel a trustee to abandon the bankruptcy estate or interest in a debtor's real property.

Adversary Proceedings
The Bankruptcy Rules provide that certain types of relief may not be obtained by motion, but by an adversary proceeding, which is commenced by the filing of a complaint. Once begun, the adversary proceeding progresses as a civil lawsuit. The bankruptcy rules govern the procedural aspects of adversary proceedings, including service. An adversary proceeding may include an action to determine the validity, priority or extent of liens or other interests in the property, or whether a debtor's personal liability for a debt should be discharged.

Notice of Bankruptcy [11 U.S.C. § 342]
Notice of filing of a petition must be provided to interested parties. A trustee must give notice by mail not less than 21 days before the first meeting of creditors [F.R.B.P. 2002].

In involuntary bankruptcy cases, a summons must be issued for service on the debtor [F.R.B.P. 1010].

Filing a Petition for Bankruptcy
A trustee is required to file a copy of the petition for bankruptcy in the office where deeds are recorded and in every county where the debtor owns real property, in order to protect the estate from the effect of a post-petition transfer of an interest to a third party [11 U.S.C. § 549(c)]. This filing constitutes constructive notice of the proceedings. In addition to the current property owner, bankruptcy actions affecting parties in the chain of title for the past 20 years must be evaluated for their effect on the title if there is actual or constructive notice of their existence.

Listing of Schedules and Statements
The following are schedules which are most likely to be reviewed by underwriters:

1. Schedule A - List of real property
2. Schedule C - List of property claimed as exempt
3. Schedule D - List of creditors holding security interest
4. Schedule G - List of executory contracts and unexpired leases.

Property of the Estate
In General – When the order for relief is obtained, essentially all non-exempt property owned by the debtors at the date of filing the petition becomes property of the estate.

The Code does not specifically provide that title to the property vests in the trustee. However, the trustee has the power to deal with the property as if it holds the title.

For the purposes of a title commitment, title should be shown as being in the debtor once the petition has been filed.

Example:
The most current deed of record places title to the property in John Doe who has filed a petition in bankruptcy. The commitment should show title as follows:

Joe Doe, subject to proceedings in the U.S. Bankruptcy Court for the __________ District of __________(State) __________ entitled In Re: John Doe Debtor, case #__________ wherein a petition was filed.

Also, an exception relating to the consequences of the bankruptcy should be set forth in Schedule B of the commitment.

Bankruptcy

Fraudulent Conveyance

THE BANKRUPTCY TRUSTEE OR A DEBTOR IN POSSESSION HAVE POWERS TO SET ASIDE CONVEYANCES AND MORTGAGES WHICH WERE MADE PRIOR TO THE COMMENCEMENT OF THE BANKRUPTCY PROCEEDINGS. IF EVIDENCE INDICATES THE POSSIBILITY OF THE APPLICATION OF THESE POWERS IN A FUTURE BANKRUPTCY TO TRANSFERS BACK IN THE CHAIN OF TITLE, IT IS NECESSARY TO RAISE AN APPROPRIATE SCHEDULE B EXCEPTION. THE CREDITORS' RIGHTS EXCLUSION FOUND IN CURRENT ALTA POLICY FORMS ONLY APPLIES TO THE PRESENT TRANSACTION CREATING THE INTEREST BEING INSURED.

Pre-Petition Matters

The court will consider transactions which the debtor entered into prior to the bankruptcy to establish that the debtor did not convey or transfer property so as to hinder or defraud creditors or provide preferential treatment to certain creditors.

Pursuant to 11 U.S.C. §§ 548, 547 and 544 – A trustee has the power to avoid pre-petition liens or transfers if they are deemed to be either fraudulent or preferential.

Fraudulent Transfers

The bankruptcy court can set aside transfers made within two years prior to the filing of the petition in bankruptcy if the transfer:

A. Was made with the intent to hinder, delay or defraud creditors (actual fraud);

B. Was made for less than a reasonably equivalent value and the debtor was insolvent when the transfer was made or became insolvent as a result of the transfer;

C. Debtor is unable to pay debts as they become due. A fraudulent transfer is one made with actual intent to defraud or under conditions that a court would find that a constructive fraud occurred. Even if a year has expired since the transfer, the avoidance powers of the trustee may still be exercised under applicable state law.

EXAMPLES

A. X purchases the stock of Corporation. X borrows money from a bank to pay the selling stockholders of Corporation and induces Corporation to mortgage its assets as security for X's debt. Corporation does not receive the mortgage funds or benefit from its use. If Corporation was insolvent or if the amount of the mortgage lien when added to the existing debt of Corporation renders Corporation insolvent, the mortgage may be deemed to be a fraudulent transfer and voidable.

If the mortgage lien is voided, the lien (if it continues to exist) may be junior to all unsecured debts. Even if the mortgage amount when added to existing liabilities will not render Corporation insolvent, the debt service necessary to pay debts may be so great that Corporation will be unable to pay its debts as they become due. In such a case, the transfer may still be voidable.

B. Corporation A borrows money from a bank for working capital and acquisition of a new plant and equipment. Bank requires all subsidiaries of Corporation A to guarantee A's debt and to give the bank a lien on the assets of the subsidiaries as collateral for the guarantees.

Since the subsidiaries may not receive a reasonably equivalent value for the guarantee, a court might avoid the mortgage. These are called "upstream guarantees." The same problem may exist if a corporation guarantees a sister corporation's debt. These are called "cross-stream" guarantees.

Good faith transferees who may not have given a reasonably equivalent value will still have the lien on the transferor's property to the extent of the value actually given, even if the transfer is avoided.

Good faith second and subsequent transferees without actual knowledge of the voidability of the initial transfer who give value will take free of the trustee's power to avoid the initial transfer.

A trustee may avoid a transfer if it constitutes a preference and the transfer was made within 90 days of the commencement of the bankruptcy case or within one year of the commencement if the party receiving the transfer is an "insider". A transfer is a preference if it favors one creditor over other creditors, meaning that the favored creditor receives more than what would have been its pro-rata distribution in a liquidation of the debtor's assets.

The most common type of transfer that will be attacked as a preference is a mortgage given to a creditor to secure a prior debt. In order for the trustee to avoid the transfer as being a preference, it must have been made when the debtor was insolvent. As to insider involvement in a particular transaction, lenders were concerned about the consequences of a court decision entitled In Re De Prinzio Construction Co., 874 F.2d 1186 7th Cir. (1989). The court found that a payment, or other transfers received by a non-insider lender from its borrower within one year of the borrower's bankruptcy filing, rather than the 90 days non-insider period, had to be repaid as a preference where the loan was guaranteed by an insider of the borrower. The Bankruptcy Code allows for the setting aside of transfers made for the benefit of creditors. The transfer to the lender indirectly benefited the insider as it limited the insider's liability under the guarantee. The insider was considered a creditor since it had a right of subrogation under the mortgage against the debtor.

The Reform Act amendment to 11 U.S.C. § 550 (c) now provides that the trustee may not recover a preference made more than 90 days and less than one year prior to bankruptcy from a transferee that is not an insider. Therefore, under the current law, a lender who is not an insider can take a guarantee by an insider of the debtor (e.g., in a corporate setting, an insider includes an officer and director) without concern of being subject to the one year rather than the 90 day preference period under the Code. [11 U.S.C. § 547].

If a mortgage lien is perfected under state law within thirty days after equivalent value is actually given, it is not subject to avoidance as a preference. One way perfection may occur is to record the document. State law will determine whether perfection by recordation occurs when the document is accepted for recording or when it is indexed. In certain states, a sizable gap in time exists between tender of the document for recording and its indexing. In addition, a court may find that the transfer was part of a transaction that can be considered a contemporaneous transaction and thus not subject to avoidance.

The Reform Act amends §546(a) of the Code to provide that the statute of limitations to avoid a preferential or fraudulent conveyance by a debtor in possession or trustee is the later of (a) two years after the order for relief (petition date in a voluntary case), or (b) one year after the appointment or election of the first trustee if the appointment or election occurs before the expiration of the two-year period. The Bankruptcy Code provisions are similar to the Uniform Fraudulent Conveyance Act adapted by many states. Other states have adopted similar but non-uniform fraudulent transfer laws. Applicable statutes of limitation vary by state and may be longer than the Code's two year limit.

Bankruptcy

Creditors' Rights

REQUESTS FOR THE DELETION OF THE CREDITORS' RIGHTS EXCLUSION OR FOR AFFIRMATIVE COVERAGE OVER THE CREDITORS' RIGHTS RISK IS AN EXTRA-HAZARDOUS RISK AND REQUIRES THE APPROVAL OF YOUR COMPANY'S UNDERWRITING ADVISER.

The Company does not offer Creditors' Rights coverage, and the ALTA 21-06 affirmative endorsement has been decertified.

Creditors' Rights Exclusion

Current ALTA title insurance policy forms have been amended to add the following exclusion from coverage for certain creditors' rights issues. <u>The exclusion applies only to the transaction creating the interest being insured</u>.

LOAN POLICY

Any claim, which arises out of the transaction creating the interest of the mortgagee insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that is based on:

(i) The transaction creating the interest of the insured mortgagee being deemed a fraudulent conveyance or fraudulent transfer; or

(ii) The subordination of the interest of the insured mortgagee as a result of the application of the doctrine of equitable subordination, or

(iii) The transaction creating the interest of the insured mortgagee being deemed a preferential transfer except where the preferential transfer results from the failure:
(a) to timely record the instrument of transfer; or
(b) of such recordation to impart notice to a purchaser for value or a judgment or lien creditor.

OWNER'S POLICY
Any claim, which arises out of the transaction vesting in the insured the estate or interest insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, that is based on:

(i) The transaction creating the estate or interest insured by this policy being deemed a fraudulent conveyance or fraudulent transfer, or

(ii) The transaction creating the estate or interest insured by this policy being deemed a preferential transfer except where the preferential transfer results from the failure:
(a) to timely record the instrument of transfer; or
(b) of such recordation to impart notice to a purchaser for value or a judgment or lien creditor.

Consideration should be given to adding an additional creditors' rights exception after reviewing the consequences of prior transactions in the chain of title. The refinancing of a leveraged buyout would be an example of a situation where the creditors' rights implication of a prior transaction would have to be evaluated, as would a modification of a pre-existing loan.

Title Insurance Concerns
There are continuing requests from customers to eliminate or modify the standard bankruptcy exclusions appearing in title insurance policies as well as exceptions included in policies issued for certain types of transactions or in the alternative to provide affirmative insurance with respect to creditors' rights issues. As mentioned above, the Company does not offer Creditors' Rights coverage, and the ALTA 21-06 affirmative endorsement has been decertified

Bankruptcy

Sales or Leases of Property

THE BANKRUPTCY TRUSTEE HAS THE POWER TO SELL, LEASE OR MORTGAGE PROPERTY OF THE ESTATE UNDER CERTAIN CIRCUMSTANCES AS SPECIFIED IN THE CODE.

Administration of the Case
A trustee may sell or lease property of the estate and notice and a hearing is not required if the sale or lease is in the ordinary course of the debtor's business. [11 U.S.C. § 363].

Rejection of a contract of sale by trustee or debtor in possession is treated in the same way as rejection of a lease where trustee or debtor in possession is the lessor. If the buyer is in possession, the buyer may treat the contract as terminated or, in the alternative, remain in possession.

Sale Subject to Liens
The trustee is free to sell real property after notice to an interested party provided there are no objections or requests for a hearing. Generally, no order is necessary unless there are objections. Bankruptcy judges often refuse to issue "comfort orders" to title insurers.

Sale Free and Clear of Liens
The Bankruptcy Code provides for the sale of property free and clear of liens (and encumbrances) if one of the following circumstances exists: [11 U.S.C. § 363 (f)]

1. Applicable non-bankruptcy law permits the sale of such property free of such interest.

2. Lienholders consent to the sale – receipt of notice of motion to sell and no objection to the sale constitutes consent.

3. The liens will be paid in full from the sale proceeds.

4. The lien is involved in a bona fide dispute.
5. Such entity could be compelled in a legal or equitable proceeding to accept a money satisfaction of the lien.

F.R.B.P. 6004 requires that, before a trustee can sell free and clear of a specific lien or interest, a motion for authority to sell property free and clear of liens shall be made in accordance with F.R.B.P. 9014 and shall be served on the parties who have liens on the property to be sold. Pursuant to the Code, notice must be given which shows:

1. Date of hearing on the motion.
2. Time objections must be filed.
3. The conditions relied upon to justify the sale free of the interest.

We are frequently asked to insure a sale or mortgage from the debtor-in-possession or the Trustee to a third party free and clear of liens. The notice described above must be examined carefully and the order issued by the court followed exactly. The liens should shift from the property to the proceeds of the sale. The order may provide that the sale is free and clear of taxes and/or recording fees. Do not provide coverage upon receipt of documents (i.e. "marking up the commitment at closing") if you have not discerned that the Register/Recorder will accept a certified copy of the order in lieu of the recording fees/mortgage taxes. In addition, if you are requested to delete State, County or Municipal taxes or liens in reliance upon the order, you must have approval of your Company Underwriting Advisor before proceeding. There are real jurisdictional issues that must be analyzed before we can rely upon such an order to bind the State or its subdivisions and/or agencies.

EXAMPLE
The trustee wants to sell property which is subject to certain filed mechanics' liens. The trustee disputes the validity of the liens and moves to sell free and clear of those interests. The proposed sales price will be sufficient to pay a portion of the liens. All such lien claimants must be made part of the adversary proceedings. The court order may authorize the sale free and clear of the mechanics' liens and transfer the liens to the proceeds. Payment to the extent that funds are available will be made after the mechanics' liens issue has been resolved by litigation.

Bankruptcy Rule 6004(h) provides: "An order authorizing the use, sale or lease of property other than cash collateral is stayed until the expiration of 14 days after the entry of the order, unless the court orders otherwise". Courts often waive this *stay of entry* in the order to sell. THIS DOES NOT EFFECT THE APPEAL PERIOD for that order. In the light of recent case law, the Company will not waive the appeal period. In addition, if an appeal is filed within 14 days, we will require the appeal to be resolved even if no stay pending appeal has been filed and approved.

Sale in the Ordinary Course of Business [11 U.S.C. § 363(c)]
Debtors in possession who are carrying on the business of the debtor are free to sell property in the ordinary course of the debtor's business.

Trustees in Chapter 7 liquidation cases, however, must obtain a court order authorizing the trustee to carry on the debtor's business. Once a court order is obtained, the trustee is free to sell in the ordinary course.

A sale should be carefully evaluated in determining whether real property was, in fact, sold in the ordinary course of the debtor's business.

What constitutes a sale in the ordinary course may be difficult to determine. Probably, if a subdivision developer who is in the business of selling lots is in bankruptcy, a sale of lots to builders would be deemed to be a sale in the ordinary course of the subdivision developer's business. In most instances, however, the situation is not so clear.

If a trustee obtains a court order authorizing the operation of a business, it should not be difficult to require that the order specify what types of sales are in the ordinary course of the debtor's business. In such cases, we would be willing to insure without notice and hearing. Other sales must be evaluated on a case-by-case basis.

Sale of Co-Tenants Interest
Bankruptcy Code [11U.S.C.§§363(h)–(j)] authorizes a bankruptcy trustee, under certain conditions and pursuant to a bankruptcy court order, to sell property which the debtor owned jointly with another person or persons, and to distribute the sale proceeds to the bankruptcy estate and the other co-owners. If a court finds that a better price can be obtained by selling the property as a whole, it will authorize the trustee to do so.

F.R.B.P. 7001(3) requires the trustee proceed against the non-debtor, including a tenant by the entirety, by adversary proceeding to obtain a ruling that a proposed sale of the property satisfies the requirements of 11 U.S.C. § 363(h). This section provides that the trustee may sell property held by the debtor and his spouse or co-tenant if the trustee satisfies four conditions, namely that, (a) partition would be impractical, (b) the sale of the debtor's interest alone would yield significantly less to the estate than the sale of the whole property, (c) the property not be used in the production, transmission or distribution of electricity or natural gas, (d) the benefit to the estate of a sale of the whole property free of the interests of the co-owners outweighs the detriment, if any, to such co-owners. The latter condition is often difficult to establish especially where property is held in tenancy by the entirety. The debtor's spouse or a co-owner of the property as the case may be, retains a right of first refusal to purchase the property at the price at which such sale is to be consummated.

When insuring title involving the sale by a trustee of property held in co-ownership or by the entirety, we should require a final non-appealable court order authorizing such sale. In addition, the right of first refusal in favor of the non-debtor spouse or co-owner must be disposed of.

Notice Provisions

F.R.B.P. 2002 sets forth the requirements of notice when a trustee wishes to sell real property.

Twenty-one (21) day notice by mail must be given to the debtor and all creditors other than for sales made in the ordinary course of business. The court for cause shown may shorten the time and method for giving notice. The notice must show the following:

A. The time and place of any public sale;
B. The terms and conditions of any private sale;
C. The time fixed for filing objections; and
D. Description of the property.

Authority to Borrower Money [11 U.S.C. § 364]

A trustee authorized by the court to operate a business may borrow money, if necessary, in the ordinary course of the business. After notice and hearing, a trustee may be authorized to borrow money on an unsecured basis. Such loans may be considered administrative expense and thus have the same priority afforded to administrative expenses.

The Code also provides that the trustee, or the debtor in possession, may obtain secured credit with priorities over other secured creditors provided that the need can be justified to the court.

EXAMPLE

X undertakes to build an apartment complex and obtains a construction loan from a bank. In the course of the development, it becomes clear that the construction funds are not sufficient to complete the project. X files under Chapter 11 for reorganization. The bank is willing to lend additional money to complete the project, provided it is given priority over other secured indebtedness such as mechanics' liens. If the court is satisfied that the completed project will be an asset to the estate, the court might grant to the bank a super priority lien on the construction project to secure the additional funds. Lenders who are granted super priority liens will be protected against an adverse decision on appeal unless the order authorizing the loan is stayed by court order.

Bankruptcy

AUTOMATIC STAYS

THE FILING OF THE PETITION IN BANKRUPTCY OPERATES AS AN AUTOMATIC STAY AGAINST THE COMMENCEMENT OR CONTINUATION OF AN ACTION TO ENFORCE A LIEN AGAINST THE LAND.

Automatic Stays

Upon the filing of the petition in bankruptcy, all creditors must cease any action against the debtor's property. Creditors cannot file or continue suits, foreclose on property of the debtor, or seek to enforce existing liens against the debtor's property. Foreclosure actions may be stayed even by a bankruptcy filing made post judgment, but prior to the transfer of title under a foreclosure sale. A foreclosure sale that takes place after the filing of a petition for relief is probably void.

Creditors of the debtor have no recourse outside of the bankruptcy unless the court lifts or modifies the stay. The stay continues against property of the estate until the case is closed or earlier resolved upon motion of the creditor. Title insurance coverage should not be provided when a bankruptcy stay is in place covering the real property involved in the transaction.

The Code originally required that the court hold either a preliminary or final hearing within 30 days after the filing of a motion for relief from the automatic stay. The Reform Act amended §362(e) of the Code to require that the final hearing be concluded within 30 days after the conclusion of the preliminary hearing. This period may be extended only on consent of the parties or for a specified time which the court finds is required by compelling circumstances. If the debtor is an individual under Chapter 7, 11 or 13, the stay terminates 60 days after the creditor files a motion to lift the stay, unless on motion the debtor obtains a court order extending it. [11 U.S.C. §362(e) (2)]

Serial Filers

As to cases commenced on or after October 17, 2005, if a debtor files a 2nd petition within one year of filing a previous petition, the automatic stay is limited to 30 days, unless on motion the debtor obtains a court order extending it. [11 U.S.C. §362(c)(3)(A)]. Note that some courts have construed this section which limits the length of the stay to apply only to the stay against *the debtor* and **NOT** the stay against proceedings against *the estate* of the debtor.

If a debtor files a 3rd petition within a one year period, there is no automatic stay, unless the court orders that one be imposed. [11 U.S.C.§362(c)(4)]. This does not have the troublesome distinction between types of stays, since none is imposed, but there is some question as to what the term “refiled” means, which term is used as a carve out to the types of cases that fall under the section. It seems to refer to converted cases, such as when a Chapter 13 proceeding is converted to a Chapter 7 liquidation.

The Federal Rule of Bankruptcy Procedure 4001(a)(3 states: “An Order granting a motion for relief from the automatic stay made in accordance with Rule 4001(a)(1) is stayed until the expiration of 14 days after the entry of the order, unless the court orders otherwise.” The court may, therefore, order that F.R.B.P. Rule 4001(a)(3) is not applicable or may in its discretion order that the stay under F.R.B.P Rule 4001(a)(3) is for a fixed period of less than 14 days. Entry of the order means entry “on the docket”. Therefore, we should treat an order lifting the §362 automatic stay as lifted only after such order is entered on the docket, 14 days or such lesser or greater time as the court has specifically directed has expired, and no appeal from the order has been filed.

Bankruptcy

Abandonment and Exemptions

GENERALLY, ALL THE DEBTOR'S INTERESTS IN LAND ARE SUBJECT TO THE JURISDICTION OF THE BANKRUPTCY COURT UNTIL THE CASE IS CLOSED. PROPERTY WHICH IS BURDENSOME TO THE ESTATE OR OF LITTLE VALUE MAY BE ABANDONED. SOME INTERESTS MAY BE EXEMPT BY LAW.

Abandonment of Property [11 U.S.C. § 554]
A trustee has a duty to either sell or abandon those assets which are burdensome to the estate or are of little value. A trustee may abandon property after a notice and hearing. If no one requests a hearing, none is required. If the trustee fails to abandon property, any party in interest may request the trustee to abandon. In such cases, a hearing is required.

Property which is duly abandoned may be disposed of by the debtor without regard for the bankruptcy proceeding. If property has been scheduled, but not administered, and the period for appealing the closing of the proceedings has passed, the property should be treated as having been abandoned with approval of the court. If the property has a value of $100,000 or more, an order of abandonment should be obtained under the rules without reopening the proceedings.

If the property had not been scheduled and the proceedings closed without an order of abandonment, the proceedings may be subsequently reopened by a creditor. In such circumstances, an order of abandonment should be obtained. If the property is worth less than $100,000, the order of abandonment should be obtained under the rules without reopening the case. If the property is worth more than $100,000, the case should be re-opened. Since this information appears of record, a purported bona fide purchaser might not be protected.

Exemptions
The Code does not affect exempt property which the bankrupt has under federal law or under the law of the state where the bankrupt had been domiciled for 6 months prior to filing his petition. Exempt property is included in Schedule C of the

petition and if no objections are filed within 30 days after the conclusion of the first meeting of creditors, the claim of exemptions are deemed approved by the court. The homestead exemption is one such exemption which many states provide. Some states establish a dollar limit on the amount of homestead property which may be exempt, and if property exceeds this limit, the property may not be treated as exempt by the court. We may also rely on a final non-appealable court order confirming the claim of exemption and removing it from the jurisdiction of the Bankruptcy Court. Pre-existing liens follow exempt property unless otherwise avoided.

If the debtor elects to claim exemptions allowed by state law, the nature and extent of the exemptions vary, depending on the length of time the debtor has been domiciled in the state where the bankruptcy filing occurred. In order to claim the full state exemptions, the debtor must have been domiciled in that state for the 730 days immediately preceding the filing [11 USC §522(b)(3)(A)]. Additionally, a residential homestead exemption is limited to $1140,450 (in equity) if the residence was acquired within the 1215 days immediately preceding the filing [11 U.S.C.§522(p)]. If the debtor has not been domiciled in a single state for the 730 days immediately preceding the filing, he can claim the exemptions allowed by the state in which his domicile was located for the 180 days immediately preceding the 730 day period, or, the state where he was domiciled for a longer portion of such 180 day period than in any other state [11 U.S.C. §522(b)(3)(A)].

Bankruptcy

Executory Contracts and Leases

THE TRUSTEE HAS THE POWER TO ASSUME OR REJECT EXECUTORY CONTRACTS AND UNEXPIRED LEASES.

Assumption and Rejection of Executory Contracts and Leases

The Code gives the trustee the power to assume or reject executory contracts and unexpired leases. Several cases have narrowly interpreted the statute by limiting a tenant's right to assign the lease and not allowing the enforcement of covenants contained in the lease. The Code now clarifies the treatment of leases, previously questioned by these court decisions, when the debtor lessor rejects such an unexpired lease of real estate in bankruptcy and the lessee elects to remain in possession for the balance of the term including renewal periods. The lessee, including any successor, assignee or mortgagee, now specifically retains all rights which are appurtenant to the leasehold estate. In Chapter 7 cases, executory contracts and leases of residential and nonresidential property, if not assumed or rejected within 60 days from the date of the order of relief, are deemed rejected unless the court extends the time.[11U.S.C.§365(d)]

In Chapter 11 and 13 cases, the trustee can assume or reject executory contracts and leases of residential property at any time before confirmation of the plan unless the court requires earlier action.

In all other cases, executory contracts and leases of nonresidential property, if not assumed or rejected within 60 days, will be deemed to be rejected unless the court extends the time.

If a trustee determines that a particular contract or lease constitutes a salable asset, it has the power to sell even if an assignment is prohibited in the agreement. However, adequate security might have to be given to the other party.

A contract or lease in default for reasons other than insolvency or bankruptcy of the debtor cannot be assumed by the trustee unless the default is:
- cured;
- damages, if any, paid; and
- adequate assurance is given of future performance.

Rejection by a trustee where the debtor is the vendee under a contract of sale for real property or a lessee under a lease constitutes a breach for which the estate may be liable for damages. The same is true where the debtor is the lessor under a lease or the vendor under a contract for sale. However, the Code protects contract purchasers and lessees if they are in possession of the property pursuant to the contract or the lease. The trustee cannot terminate a leasehold estate or the equitable estate of a vendee under a conditional sales contract if the party is in possession pursuant to the contract or lease and neither agreement is in default.

EXAMPLE
X leases property to Y. X files a bankruptcy petition. Y is in possession pursuant to the lease. Y has a leasehold estate which cannot be terminated by X's trustee.

EXAMPLE
X enters into a sales contract with Y whereby Y takes possession and agrees to pay X in installments over a period of time. X files a bankruptcy petition. X's trustee cannot terminate Y's equitable title.

The trustee may be permitted to terminate any personal obligations of the seller or the lessor.

Possession under a lease with an option to purchase is not, in the Company's opinion, possession contemplated by the Code. for the purpose of protecting the option from rejection. In such a situation, a trustee of the lessor/optionor may reject the option. Possession must be pursuant to the agreement sought to be rejected.

Termination Provisions in Contracts or Leases are Unenforceable [11 U.S.C. § 365(e]
As a general principle, a provision in the contract or lease providing for cancellation or termination upon the bankruptcy or insolvency of a party is not enforceable against the trustee provided no other condition of default exists.

Bankruptcy

Judgment Liens

THE DISCHARGE OF A DEBT IN BANKRUPTCY RELIEVES THE DEBTOR OF PERSONAL LIABILITY FOR THE DEBT BUT A PRE-EXISTING VALID LIEN ON THE LAND IS NOT AFFECTED BY THE DISCHARGE.

Liens Perfected Before Bankruptcy Against Property of the Estate

Judgment liens and other liens which are perfected prior to the petition for bankruptcy against property of the estate continue even though the debt may be discharged and the property abandoned or claimed as exempt. State law, however, may prevent collection against exempt property.

Although the Code [11 U.S.C.§ 524(a)] would indicate that the debt based upon which the judgment was based is extinguished, the legal effect of the discharge is limited to enjoining a judgment creditor from proceeding against the debtor in a personal action. *The creditor is not prohibited from proceeding against the property owned by the debtor prior to the petition for bankruptcy.*

> *EXAMPLE*
> X owns property which is subject to a judgment lien. X files a petition under Chapter 7. The trustee abandons the property because the value of the property does not exceed the total amount of the liens which had attached to the property. The case is closed, and the debt represented by the judgment is discharged. The judgment creditor can proceed against the property unless enjoined under state law.

There are cases, however, which hold that the judgment creditor is enjoined from proceeding against pre-petition property after the bankruptcy case is closed and the debt discharged.

To the extent that a judgment lien might impact on an exemption available to the debtor, it is possible for a debtor to proceed under 11 U.S.C. § 522(f) to void the judgment.

EXAMPLE
X owns real property worth $100,000 subject to a $70,000 first mortgage and a $30,000 judgment lien. State law gives X a $40,000 exemption. X files a Chapter 7 proceeding and claims his exemption. The court orders the judgment voided under 11 U.S.C. § 522(f). The real property is abandoned and X sells for $100,000, paying the lender $70,000 and retaining $30,000 free of the creditors.

Any request to insure property free of the lien must be approved by your Company underwriting advisor.

Liens Perfected Before Bankruptcy on After-Acquired Property
After a case is closed and the debt which was the basis for a judgment lien is discharged, the judgment creditor is enjoined from proceeding against property acquired by the debtor after the bankruptcy case was commenced.

After-acquired property means property acquired after the case is closed in Chapters 11, 12 and 13 proceedings. In Chapter 7 cases, after-acquired property means property acquired after the order for relief, except for certain types of property which vest in the debtor within 180 days after the commencement of the case.

However, before insuring title without showing the judgment as a lien against after-acquired property, it is necessary to examine the bankruptcy case to make sure that the debt represented by the judgment was duly listed and discharged.

If pre-acquired property is abandoned because no equity exists which would be available for distribution to creditors by the trustee, a pre-petition judgment creditor is free to proceed against the real estate to the extent of any value existing at the date the property is abandoned. In theory, the judgment creditor is enjoined from proceeding against the property to the extent that the value increased subsequent to the date of the closing of the case due to inflation.

Bankruptcy

Appeals

WHEN A COURT ORDER IS REQUIRED, IT IS INTENDED THAT THE ORDER BE FINAL AND THE APPEAL PERIOD HAS EXPIRED.

Bankruptcy Rule 6004(h) provides: “An order authorizing the use, sale or lease of property other than cash collateral is stayed until the expiration of 14 days after the entry of the order, unless the court orders otherwise.”

An appeal from a final judgment, order or decree of a Bankruptcy Court can be taken either to the District Court or a Bankruptcy Appellate Panel if one has been established by the judicial council of the federal circuit. A further appeal from those tribunals is taken to the Circuit Court of Appeals. The bankruptcy rules set forth procedures for appeal. [Bankruptcy Rules Part VIII].

For example, a notice of appeal from an order authorizing the sale of real property free and clear of all liens and encumbrances must be filed with the clerk of the Bankruptcy Court within 14 days of the date of the entry of said order directing the sale and not from the date written notice of entry of the order is served on the appellant. [F.R.B.P. 8002(a)]

The time for filing a notice of appeal may be extended by a bankruptcy judge for a period not to exceed 21 days from the expiration of the time otherwise prescribed. [F.R.B.P. 8002(c)] While a request to extend the time for the filing of a notice of appeal ordinarily must be made before the time for filing a notice of appeal has expired, a request made within 21 days after the expiration of the time for filing a notice of appeal may be granted upon a showing of “excusable neglect”, but only if the order appealed is not one authorizing, among other things, the sale of the property. [F.R.B.P. 8002(c)]

11 U.S.C. § 363(m) provides a purchaser of property from a debtor with protection against a subsequent appeal of the order authorizing such sale. This section provides that:

> "The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale were stayed pending appeal."

Thus, a purchaser who bought the property in "good faith" from the debtor should be protected against a reversal on appeal of the order authorizing the sale, provided such reversal occurs after the sale has closed and the order authorizing the sale has not been previously stayed. The term "good faith" is not defined in the Code. Misconduct that may adversely affect a purchaser's good faith status at a judicial sale could involve fraud or collusion between the purchaser and other bidders or the trustee.

A motion for a stay pending appeal is usually made to the Bankruptcy Court in the first instance. The denial of the stay by the Bankruptcy Court can be appealed to the District Court or the Bankruptcy Appellate Panel, in those districts where one is present. As a practical matter, any motion for a stay pending appeal, if sought, will in all likelihood, be filed with the notice of appeal immediately after the entry of the order or at the latest within 14 days of the entry of the order. The Company position is that we will raise the right of appeal and not insure over it until the appeal period has run, or any appeal taken is satisfactorily concluded. If the appeal period is still running, or an appeal has been filed without an corresponding application for a stay, or an application for a stay has been made but has not yet been decided, or denial of a stay is on appeal, 11 U.S.C. § 363 (m) should <u>not</u> be relied on as the basis for insuring the transaction. Any request for this type of coverage must be referred to your Company underwriting advisor.

The granting of a stay will often be conditioned upon the filing of a bond or other appropriate security with the court.

Finally, two caveats should be noted. First, if the closing of the specific sales transaction was expressly conditioned, in the purchase and sale agreement, upon the entry of a final non-appealable order approving the sale, it is possible that a court may construe such provision as a consensual stay between the parties. Moreover, if notice was not provided by the debtor to a party holding a lien on the property which was sold, 11 U.S.C. §

363(m) will not provide the purchaser with protection against such lienor. When insuring title to the purchaser and any mortgagee of the purchaser, it is essential that we be satisfied that all parties claiming liens against the property have been duly served in accordance with the order entered on the application to the Bankruptcy Court for authorization to sell.

Bankruptcy

Discharge, Conversion, Reopening Cases and Dismissal

DISCHARGE MEANS THAT A DEBT IS FORGIVEN BUT NOT EXTINGUISHED. CASES COMMENCED UNDER ONE CHAPTER CAN BE CONVERTED TO ANOTHER. CREDITORS CAN REOPEN A CASE TO ADMINISTER ASSETS. DISMISSAL GENERALLY RETURNS THE DEBTOR'S FINANCIAL AFFAIRS TO THE STATUS QUO.

Discharge [11 U.S.C. §§524, 727, 1141, 1228, 1328]
A discharge, if granted by the court, means that a debt is forgiven but NOT extinguished.

Only debts of individuals may be discharged in Chapter 7 cases. There are debts, however, that are not subject to discharge. These include debts arising out of student loan, alimony, child support, certain types of taxes and obligations resulting from fraud. 11 U.S.C. § 523 sets forth the types of debt not subject to discharge.

In Chapter 11 cases, discharge of a debt occurs upon confirmation of the plan if neither the plan nor the order confirming the plan provides otherwise.

In Chapters 12 and 13 cases, discharge does not occur until after the debtor pays all debts as required by the plan.

As indicated, only debts of individuals can be discharged, not those of a corporation or partnership. Therefore, if there is evidence that the assets of a corporation or partnership were liquidated in a Chapter 7 proceeding, and if for some reason the entity continues in business, all judgments will attach to subsequently acquired property.

Conversion [11 U.S.C. §§348, 706, 1112, 1208, 1307]
Cases commenced under one chapter of the Bankruptcy Code can be converted to another chapter. Chapters 11 and 13 cases are usually converted to a Chapter 7 case when it appears that reorganization is not feasible.

Since the law is unclear with respect to the effect of a conversion, we should not assume that certain orders, such as an order lifting a stay while a Chapter 11 proceeding was in effect, would still be applicable if it is converted to a Chapter 7 case.

Reopening Cases [11 U.S.C. §350]
Creditors of a debtor have the right to reopen a case to administer assets which were not listed as assets of the estate when the petition was filed.

Also, if the debtor fails to list a debt of a particular creditor, that creditor is not enjoined from further collection activity, even though the case has been closed.

Dismissal of a Case [11 U.S.C. §§349, 109(g), 707, 1112, 1208, 1307]
With the approval of the court, all bankruptcy cases can be dismissed.

Dismissal has the effect of revesting title in a debtor, vacating some court orders, such as those voiding a transfer, and generally returning the debtor's financial affairs to the status quo.

Interests acquired by a third party, such as purchasers of real property from a trustee, are protected.

Chapter 13 cases may be dismissed at the will of the debtor. However, the debtor is prohibited from refiling a petition for bankruptcy for 180 days if the dismissal came after an order granting relief from the automatic stay.

Bankruptcy

BFP v. Resolution Trust Corporation

THE SUPREME COURT IN BFP V. RESOLUTION TRUST CORPORATION HELD THAT A REASONABLY EQUIVALENT VALUE FOR FORECLOSED PROPERTY IS THE PRICE IN FACT RECEIVED AT THE FORECLOSURE SALE, SO LONG AS ALL THE REQUIREMENTS OF THE STATE'S FORECLOSURE LAW HAVE BEEN COMPLIED WITH. HOWEVER, SEE THE DISCUSSION OF WHITTLE DEVELOPMENT, INC V. BBTC BELOW FOR SOME DISCUSSION OF THE PREFERENCE PROBLEM NOT ADDRESSED IN THE BFP CASE.

The various circuits of the United States Courts of Appeals have long debated the appropriate test of "reasonable equivalent value" in the context of a mortgage foreclosure sale.

On May 23, 1994, the United States Supreme Court rendered its decision in *BFP v. Resolution Trust Corp*., 114 S. Ct. 1757 (1994). In a five-to-four decision, the Court held that **a reasonably equivalent value for foreclosed property is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with.**

In a footnote, the Court observed that their opinion "covers only mortgage foreclosures of real estate. The considerations bearing upon other foreclosures and forced sales (to satisfy tax liens, for example) may be different."

The majority declined to read the phrase "reasonably equivalent value" in 11 U.S.C.§548(a) to mean, in its application to mortgage foreclosure sales, either "fair market value" or "fair foreclosure price" (whether calculated as a percentage of fair market value or otherwise). The majority stated that "we deem, as the law has always deemed, that a fair and proper price, or a 'reasonably equivalent value' for foreclosed property, is the price in fact received at the foreclosure sale, so long as all the requirements of the State's foreclosure law have been complied with."

The Court also noted that "it is 'black letter' law that mere inadequacy of the foreclosure sale price is no basis for setting the sale aside, though it may be set aside (under state foreclosure law, rather than fraudulent transfer law) if the price is so low as to 'shock the conscience or raise a presumption of fraud or unfairness' [citing Osborn, Real Estate Finance Law, 1979]".

In the majority opinion, Justice Scalia stated, "Any irregularity in the conduct of the sale that would permit judicial invalidation of the sale under applicable state law deprives the sale price of its conclusive force under 11 U.S.C.§548(a)(2)(A), [*now 11 U.S.C. §548 (a)(1)(A)*] and the transfer may be avoided if the price received was not reasonably equivalent to the property's actual value at the time of the sale (which we think would be the price that would have been received if the foreclosure sale had proceeded according to law)."

Keep in mind that the holding applied only **to mortgage foreclosures**. However, irregularities in the proceedings, including sale prices that would shock the conscience of the court, must be evaluated. **Deeds in lieu of foreclosure do not enjoy this protection.**

Since the original *BFP* holding, the US Bankruptcy Court of the Northern District of Texas distinguished the *BFP* case in *Whittle Development, Inc. v. Branch Banking & Trust Company.* It held that a debtor can avoid a prepetition foreclosure as a preference. The lender had foreclosed on the debtor's property through a credit bid for less than the alleged market value, resulting in a substantial deficiency. The *BFP* case had analyzed the phrase "reasonably equivalent value" in Section 548, which addresses fraudulent conveyances. However, the court in *Whittle* analyzed Section 547, which addresses preferences, and said "(i)f a creditor executes on a secured property and obtains the property for what is found to be less than what it would have garnered in a hypothetical liquidation, the transfer may be avoided under the plain meaning of section 547(b)". Therefore, there is risk to the lender which buys property at its own foreclosure at an artificially low price, that the foreclosure may be avoided by the bankruptcy debtor.

Foreclosures by non-insider creditors may not be set aside as a preference if they occur more than 90 days before the bankruptcy is filed.

Co-Ownership

Tenancy in Common

IF OWNERSHIP IS IN TENANTS IN COMMON, SHOW IN YOUR TITLE VESTING IN THE COMMITMENT, THE NAMES OF ALL OWNERS AND SPECIFY AS "TENANTS IN COMMON." IF THE OWNERSHIP PERCENTAGE OF ANY OF THEM IS DIFFERENT FROM THAT OF ANY OF THE OTHERS, THEN SHOW THE PERCENTAGE OF OWNERSHIP OWNED BY EACH. IF THE OWNERSHIP OF ONE OWNER IN COMMON IS TO BE INSURED, SPECIFY THE SOURCE OF TITLE OF THAT OWNER'S INTEREST.

In most states, a deed or devise to two or more persons, who are not married to each other, and with no special qualifying language, creates a tenancy in common. In this form of co-ownership, each tenant has a legal right to possession of all of the land. There is no right of survivorship, no separate legal entity as in tenancy by the entirety, nor is there any requirement that each owner have the same percentage of interest.

For title purposes, each tenant has a separate legal estate. In order to convey or encumber the entire land, each tenant, and spouse if state law requires the joinder of the spouse, must join in the instrument. Each percentage of ownership must be accounted for. The interest of each tenant is attachable by creditors, divestible in bankruptcy, conveyable and subject to encumbrance as a separate interest. Thus, all searches must be run against all tenants in common as if each were the sole owner. If one tenant dies, the interest passes through estate or probate proceedings to heirs or legatees. Adverse possession generally would not run against the tenant in common in favor of another tenant in common, unless an ouster occurs. An ouster is an act of a co-tenant which excludes the other co-tenant from the legal right to share possession. In many jurisdictions, the ouster of co-tenants, with proper notice, will commence the running of the statute of limitations for purposes of adverse possession.

Insurance of less than 100 % of ownership
If only a percentage interest of a tenancy in common is to be insured, in one or more but not all of the tenants, the policy should specify the source of title substantially as follows:

> *X and Y as to an undivided 60% interest as tenants in common, such interest having been derived by deed dated --- from --- recorded --- as Document----.*

This is necessary so that the particular interest being insured can be distinguished from other undivided interests in the same land.

Further, when the Company is requested to issue a policy insuring only the undivided interest of one or more but not all of the co-tenants, the rights of the remaining co-tenants to bring a partition suit or to compromise the interest of the Insured should be raised as an exception in Schedule B, by use of one or more of the following exceptions, as determined by your Company underwriting advisor:

- *Rights of co-tenants to partition and contribution.*
- *Rights of other co-owners and those claiming by, through or under them.*
- *Rights of other tenants in common to use or possess the Land. The Company does not assume any liability to indemnify against loss or to defend any action arising out of a dispute regarding the use or possession of the Land.*
- *This policy insures only an undivided ___interest in the Land and does not insure against the rights or claims of the owners of other undivided interests in said Land, nor any matters affecting such other interests. Except with respect to court costs and attorney's fees, the Company, in the event of a partial loss affecting the whole title to the Land, shall only be liable for ____of such partial loss.*
- *Rights or claims of any co-tenants in the Land including, but not limited to partition, owelty, and contribution.*

Although most liens affecting the interest of one tenant in common will result only in a sale of that undivided interest, federal court decisions hold that the United States may enforce a federal tax lien, and perhaps other federal liens, by a sale of the full fee simple title in which the delinquent taxpayer holds only an undivided interest, or forfeiture of that interest. By so doing, the United States may subject all the other owners of an undivided interest to the foreclosure by notice and by providing in the judgment that their appropriate part of the net proceeds of the foreclosure sale is to be paid over to them. Since a co-tenant has an interest in the whole, in the sense that his part cannot be divided from the whole, the government may subject the whole property to sale with proportionate reimbursement to the other co-tenants.

Where a policy is issued insuring all of the co-tenants, all federal liens against all co-tenants should be shown as a matter of course. However, the problem arises where a policy is issued insuring only the undivided interest of one of the co-tenants. In such cases, the federal liens against all co-tenants should be shown on Schedule B since a lien against one co-tenant can affect all the property. Consequently, if a federal lien appears against the ownership of a co-tenant who is not the insured, insert the following exception in Schedule B:

> *The right of the United States to subject the entire fee simple interest in the land to sale upon foreclosure of its lien upon the undivided ____ interest of _____as shown by notice filed ____ as document number ________.*

In some situations you will be asked to insure a number of co-tenants in one policy. Your search will reveal the co-tenants obtained their title through different chains. Such a scenario might cause only one co-tenant to incur a loss since it is possible a defect might exist in only one of the chains. The provisions of the ALTA owner's policy call for a reduction of the amount of the policy by the same amount paid on any claim. Therefore, the payment to one co-tenant would arguably reduce the liability of the company to all of the co- tenants unless it is clearly specified that the payment to one co-tenant will reduce only that co-tenant's interest. Therefore, it is recommended that the maximum interest of each co-tenant be specified in Schedule A and the following note be placed in Schedule B or added by a separate endorsement:

NOTE: THE COMPANY AND THE INSUREDS UNDER THIS POLICY AGREE THE POLICY AMOUNT BEING AFFORDED TO EACH INSURED IS LIMITED TO THE ALLOCATIONS AS SET FORTH IN SCHEDULE A. SHOULD THERE BE A CLAIM UNDER THIS POLICY RESULTING IN A PAYMENT TO ONE

OF THE INSUREDS BASED UPON A DEFECT IN TITLE WHICH AFFECTS LESS THAN ALL OF THE UNDIVIDED INTERESTS INSURED HEREUNDER, PAYMENT WILL BE MADE TO THE CO-TENANT WHOSE INTEREST IS AFFECTED UP TO THE AMOUNT ALLOCATED IN SCHEDULE A. THE AMOUNT PAID TO ONE CO-TENANT ALONE WILL NOT REDUCE THE AMOUNT OF INSURANCE AFFORDED THE OTHER CO- TENANTS.

Co-Ownership

Joint Tenancy

IF OWNERSHIP IS IN JOINT TENANCY SHOW, IN YOUR TITLE VESTING IN THE COMMITMENT, THE NAMES OF ALL OWNERS. DO NOT DESIGNATE A FRACTION OR PERCENTAGE AS BEING OWNED BY ANY ONE JOINT TENANT. DO NOT INSURE THE OWNERSHIP OF ONE JOINT TENANT BUT ISSUE A POLICY ONLY IF IT SHOWS OWNERSHIP VESTED IN ALL JOINT TENANTS AND ALL OF THE JOINT TENANTS ARE NAMED AS THE INSUREDS IN THE POLICY.

The primary distinction between a joint tenancy and a tenancy in common is the element of survivorship. No joint tenant has an interest which will pass to heirs or devisees upon death but the surviving tenant(s) becomes the sole owner(s). Although the law in most states permits this form of ownership, it usually can be created only by an instrument which expresses the intent to create it in compliance with statutory or case law requirements. If you are issuing a policy in which you insure that the ownership is in joint tenancy, or if title is derived from the purportedly surviving joint tenant(s), you must be certain that a joint tenancy was properly created. Be sure the requirements of any relevant state statutes are followed. **It is the preferred position of the Company NOT to insure the manner in which title is held**, since the circumstances surrounding the creation of the joint tenancy may not be ascertainable from the record. For example, if state law presumes a joint tenancy from the fact that title is taken as husband and wife, and the deed discloses only the terms ”husband and wife” we should not be expanding the vesting clause in the policy to include the presumptive joint tenancy. If there is any challenge to the legality of the marriage, it could result in a claim of coverage under the policy. Sometimes a lender will insist on the inclusion of this language in the loan policy. One suggested way to do this is:

> A and B, who acquired title by deed dated __________, in which such persons are described as holding title in the following manner: [e.g., "A and B, who are married to each other, as joint tenants;" or “A and B, husband and wife, as tenants by the entirety”]

A joint tenancy can be severed by the voluntary or involuntary transfer of the interest of one joint tenant to a person other than his co-joint tenant(s). If, for example, A and B own land in joint tenancy, a deed from A to D will vest D with an undivided one-half interest which he then owns as a tenant in common with B. If A, B and C own land in joint tenancy and the interest of A is conveyed to D by a sheriff's deed arising from a judgment against A, then B and C continue to own an undivided two-thirds interest as joint tenants, but D acquires an undivided one third interest as a tenant in common. In these instances you must search for and report, consequently, encumbrances and liens affecting the interest of one joint tenant - even though the death of that joint tenant, before the enforcement of the encumbrance or lien, may cause the ownership of the surviving joint tenant(s) to be free of the encumbrances or liens. In addition, a voluntary transfer by all of the joint tenants would <u>not</u> divest any encumbrance or lien against the interest of one of the joint tenants.

State law considerations

If your state requires that a spouse join in a conveyance to release a marital interest, consider whether the spouses must join with the joint tenants in a conveyance of the entire joint tenancy. Is joinder necessary if any right of homestead is involved? Is joinder necessary, either for homestead or marital interest or both, if the transfer is made by one joint tenant only, which transfer severed the joint tenancy?

If ownership is claimed by the surviving joint tenant(s), require proof of death of the deceased joint tenant by death certificate or other satisfactory evidence and make the proof a matter of record. State law and marketability considerations may require further proceedings or recorded documentation. Although a sale or mortgage by a surviving joint tenant divests any federal estate tax lien on the interest of the deceased joint tenant, state laws as to state inheritance taxes vary. You must determine, therefore, whether an inheritance tax due the state may constitute a lien after conveyance or mortgage, and if so, make appropriate requirements.

As is always the case, state law must be considered and followed for all aspects of the effect of manner of ownership.

Co-Ownership

Tenancy by the Entirety

IF OWNERSHIP IS IN A HUSBAND AND WIFE AS TENANTS BY THE ENTIRETY, DO NOT INSURE THE OWNERSHIP OF ONE OF THOSE TENANTS. ISSUE A POLICY ONLY IF IT SHOWS THE OWNERSHIP IN BOTH TENANTS, AND BOTH TENANTS ARE NAMED AS THE INSUREDS IN THE POLICY.

A tenancy by the entirety, an estate limited to a husband and wife, is recognized in only one half of the states. It contains the element of survivorship with the survivor owning the entire title. At common law it was automatically created if the marital status existed at the time of the acquisition of ownership by the husband and wife, but some states require that the conveyance recite an intent to create this tenancy. If you are issuing a policy in which you insure that ownership is by the entirety, or if the title is derived through the purported survivor, you must be certain that a tenancy by the entirety was properly created. Be sure the requirements of any relevant state statutes are followed. **It is the preferred position of the Company NOT to insure the manner in which title is held**, since the circumstances surrounding the creation or validity of the tenancy by the entirety may not be ascertainable from the record. If there is any challenge to the legality of the marriage, it could result in a claim of coverage under the policy. In addition, some states require intent and other states may qualify by requiring that the land constitute the husband and wife's homestead.

Sometimes a lender will insist on the inclusion of this language in the loan policy. One suggested way to do this is:

> *A and B, who acquired title by deed dated __________, in which such persons are described as holding title in the following manner: [e.g., "A and B, who are married to each other, as joint tenants;" or "A and B, husband and wife, as tenants by the entirety"]*

A tenancy by the entirety cannot be terminated except by the (a) death of one tenant, in which event the survivor is the owner (some states prohibit the survivor from taking if the deceased tenant was murdered by the survivor), (b) by the divorce of the tenants, in which event each owns an undivided one half as a tenant in common, or (c) by the voluntary act of one tenant in most, but not all, states. A judgment or other similar encumbrance cannot be the basis of termination and a conveyance of both tenants will be free of mortgages, judgments and other liens made or suffered by one tenant.

A caveat, however, to the foregoing is a federal lien against one spouse. The United States Supreme Court held that a federal tax lien against one spouse can attach to entireties property. In *U.S. v. Craft*, 535 U.S. 274 (2002), and earlier cases, the Court held that the husband's interest in the entireties property constitutes "property" or "rights to property" to which a federal tax lien may attach. Since federal tax liens against one spouse will attach to entireties property, and since a termination of the estate by death, divorce or voluntary act before a conveyance by both tenants might cause such matter to affect the land, you must search for and show any such matters made or suffered by one tenant only. Since tenancies by the entirety, and their subsequently protections for the other party are state law constructions, it follows that federal liens cannot be affected.

If title is claimed by a surviving tenant by the entirety, require proof of death and no divorce prior to death and make this proof a matter of record. State law and marketability considerations may require further proceedings or recorded documentation. Consult your state statutes as to whether an inheritance tax lien attaches which is not divested by a sale or mortgage. You should also check as to whether the deceased tenant left a will which attempts to make a devise of the land which is inconsistent with the survivor owning the entire estate. Some courts have held that if the survivor claims other benefits under the will, he or she may be equitably estopped from also claiming the ownership of the land owned by the entirety (Doctrine of Election).

Co-Ownership

Community Property

ALASKA, ARIZONA, CALIFORNIA, IDAHO, LOUISIANA, NEVADA, NEW MEXICO, PUERTO RICO, TEXAS, WASHINGTON AND WISCONSIN HAVE SOME TYPE OF COMMUNITY OR MARITAL PROPERTY. THIS MEANS LAND OWNED BY A MARRIED PERSON MAY BE OWNED AS COMMUNITY PROPERTY (IN COMMUNITY), IN WHICH EVENT, THE SPOUSE OF THE OWNER IS THE OFF RECORD OWNER OF AN UNDIVIDED ONE-HALF INTEREST IN THE LAND. YOU MUST MAKE APPROPRIATE REQUIREMENTS TO DETERMINE WHETHER THE OWNER WAS MARRIED AT THE TIME OF ACQUISITION OF OWNERSHIP, IF THIS FACT IS NOT DISCLOSED BY THE PUBLIC RECORDS AND RELFECT THE OWNERSHIP OF THE SPOUSE, IF ANY, IN A TITLE POLICY OR COMMITMENT.

Land Not Owned In Community

1. In the above listed areas, if land owned by one spouse was acquired prior to the marriage, or was acquired after the marriage by inheritance, will, or gift, or was purchased with clearly traceable separate funds, it is owned by that spouse as his or her separate property.

2. In all these areas, except Alaska and Louisiana, it is also possible to create a valid joint tenancy between husband and wife, this form of ownership not being subject to the rules applicable to community property.

3. In Louisiana, upon the termination of the community property regime, said termination caused by a judgment of divorce, judgment of separation of property, declaration of nullity of a marriage, or a matrimonial agreement terminating the community regime, co-ownership is effectuated and known as Ownership in Indivision, wherein each spouse owns one-half interest in the former community property. This statutory form of co-ownership differs from general principles of co-ownership as illustrated by the fact that Indivision imposes affirmative duties to preserve and manage prudently former community property.

Further, no co-owner may alienate, encumber or lease the co-owned property without consent of the other co-owners.

Land Owned In Community

1. Generally, ownership acquired by a married person in these areas is considered to be community property and, as such, as undivided one-half interest in the land is owned by the spouse of the owner. This is on the theory that each spouse should share equally in the property acquired during the existence of the marriage without regard to the amount of the contribution made by each spouse to that acquisition.

2. While land owned in joint tenancy, or acquired by inheritance or by will, and possibly by gift, may appear clearly from the facts in the public records, the fact that land acquired with clearly traceable separate funds usually will not so appear. Do not rely on evidence furnished as to the source of funds, which is unsupported by judicial determination, as establishing that the property is separate property without the approval of your Company underwriting adviser. You should proceed on the assumption that the land acquired during the existence of the marriage, unless clearly held in joint tenancy or received by inheritance, will or gift, is community property.

3. Require that you be informed as to whether the person in title was married at the date of the acquisition of ownership, even though it may appear from the record that the estate or interest was acquired as separate property.

a. If the title holder was married at the date of acquisition and the estate or interest was not separate property, the spouse is the owner of an undivided one-half interest.

b. If the estate or interest is separate property, but the owner was married at the date of acquisition or at any time prior to conveyance, mortgage, lease or assignment of lease, in some of the states the joinder of the spouse may be necessary to relinquish the homestead interest of the spouse.

4. If property is owned in community, search for and report judgments, federal tax liens and similar encumbrances against each spouse, regardless of whether title is held of record in the name of both spouses or only one spouse.

“Community” debts affect the interest of both spouses and both interests can be sold on execution even though only one spouse incurred the debt and is the named judgment debtor. A federal tax lien against one spouse only affects the one-half interest owned by that spouse, but both interests can be sold in enforcement of a federal tax lien against one spouse only, with the other spouse being required to accept a part of the sale proceeds in lieu of ownership of a one-half interest.

5. If community property is involved, require that both spouses join in the same instrument of conveyance, mortgage, lease, etc. unless your Company underwriting adviser has authorized the acceptance of separate instruments.

6. Do not rely upon an instrument of conveyance, mortgage, lease, etc. executed by one spouse only as being sufficient to convey or encumber the one-half interest owned by that spouse.

A divorce, however, in which the court makes no specific award of the estate or interest, results in the two former spouses owning as tenants in common with each other being able to convey an undivided one-half interest. (Except Louisiana – see supra.)

7. Consult the laws of the area where the land is located as to the rights of the surviving spouse in the one-half interest owned by the deceased spouse, if the estate was owned in community on the death of the latter. Your requirements to insure should be made accordingly.

Insuring The Ownership Of Land Owned In Community

1. If the ownership of the estate or interest is vested in both the spouses reciting “husband and wife”, so state in Schedule A of the commitment substantially as follows:

John Jones and Helen Jones, husband and wife.

You should not recite that the estate or interest is owned in community. **It is the preferred position of the Company NOT to insure the manner in which title is held**, since the circumstances surrounding the creation or validity of the community or marriage may not be ascertainable from the record. You should not take any exception to community rights on Schedule B.

2. If the ownership is shown of record to be in one spouse only, but you have information that the person so named is married and that the estate or interest may be owned in community, complete Schedule A as to the ownership substantially as follows:

John Jones

And show an exception in Schedule B as follows:

Ownership in community or other rights, if any, of the spouse of the Insured.

3. If the ownership is shown of record to be in one person, but you are not aware as to whether that person is married, complete Schedule A to show that person as the owner, but insert a Schedule B exception substantially as follows:

Ownership in community or other rights of the spouse, if any, of the Insured.

4. If the estate or interest is owned as separate property by the person shown to be the owner of record, name that person in Schedule A, but do not add language, the effect of which would be to insure that the estate or interest is separate property.

5. Do not issue a policy insuring one spouse as to the one-half interest owned by that spouse in community; a policy must show that ownership of the entire estate or interest in the land in the manner specified above.

GENERAL

CAVEAT: All of the foregoing assumes that:

1. The Community Property laws and any constitutional provision of a given state govern the marital rights of non-residents in real property situated in such state. Exceptions to this are rare.

2. The same rules are generally true as to certain personal property such as ownership of mortgages. Thus, both spouses should join in the assignment, release or subordination of a mortgage. A similar rule applies to the transfer of a lessee's interest in a lease.

Corporations

Title to Corporation Property

CORPORATIONS ARE BUSINESS ENTITIES CREATED OR ORGANIZED UNDER STATE OR FEDERAL LAWS WHICH GOVERN THEIR VALIDITY OF FORMATION, ORGANIZATION, TERMS OF CONTINUED EXISTENCE AND DISSOLUTION. A CURRENT CERTIFICATE OF GOOD STANDING OR OTHER EVIDENCE OF CORPORATE EXISTENCE AND, IF THE CORPORATION IS NOT ORGANIZED UNDER YOUR STATE, A CERTIFICATE OF AUTHORITY TO DO BUSINESS IN YOUR STATE SHOULD BE EXAMINED. IT IS IMPORTANT TO CONSIDER WHETHER THE CORPORATION YOU ARE DEALING WITH WAS FORMED BEFORE IT ACQUIRED THE INTEREST YOU ARE ASKED TO INSURE, AND ALSO THAT IT CONTINUES TO EXIST AT THE DATE OF POLICY.

General

Subject to statutory provisions and limitations, corporations are empowered to acquire, use, mortgage, lease and convey real property very similarly to natural persons. Besides the statute, the corporation's own articles of incorporation (or charter) may limit these powers, and you must consider them.

If the corporation was created in another state, you must consider that state's statutory provisions and limitations, in addition to the corporation's articles of incorporation. Also, you must be furnished with evidence of the authority to do business in your state, if you determine that holding title to real estate or the corporation's usage of the land may constitute doing business.

Conveyances before or after cessation of corporate existence

Occasionally, a transfer may be made to a corporate entity before it has been validly formed. It may be necessary, absent a helpful statute, to require a confirmatory conveyance dated after the formation. Similarly, absent a curative statute, a transfer by a corporation was has been dissolved may require additional transfers from distributee stockholders or whoever is vested by law with the corporation's assets.

Franchise Taxes
The existence of a corporation can be terminated or suspended or a corporate charter can be forfeited because of the failure of a corporation to pay taxes, such as a special tax on corporations called a franchise tax (usually annual), or for failure to file required returns or reports. Consider whether failure to pay such a tax in your state results in a lien on the corporation's property.

You must require satisfactory evidence of payment of the corporation's taxes and compliance with requirements for filing reports and statements.

Good Standing
Where a corporation formed in another state will convey or mortgage, in addition to having evidence of authority to do business in your state, you must be informed by the state of incorporation that the corporation is in good standing. This is to ensure that the corporation has not been dissolved or otherwise disabled by law.

Corporations

Signatory Authority-Conveyancing and Mortgaging

*YOU MUST DETERMINE THAT THE CORPORATION HAS THE POWER TO MORTGAGE, CONVEY OR LEASE FOR YOUR PARTICULAR TRANSACTION. A CORPORATION ACTS THROUGH AGENTS, WHOSE AUTHORITY TO ACT MUST BE DETERMINED. ORDINARILY, THE BOARD OF DIRECTORS OF A CORPORATION HAS THE POWER TO AUTHORIZE A MORTGAGE OR CONVEYANCE IF SUCH IS IN THE ORDINARY COURSE OF BUSINESS. A MORTGAGE OR CONVEYANCE OF **SUBSTANTIALLY ALL OF THE CORPORATION'S ASSETS** REQUIRES MORE THAN BOARD OF DIRECTORS APPROVAL; USUALLY IT REQUIRES SHAREHOLDER APPROVAL.*

General

The applicable statute or the articles of incorporation themselves often require that shareholders consent to any transfer of substantially all of a corporation's assets. You should also obtain and review the corporation's bylaws. You must determine what percentage of shareholders must consent according to the law of the state of incorporation.

When relying on board of directors' resolutions (for transactions not involving substantially all assets), you must:

- have a certified copy of the resolutions;
- confirm that the details of the transaction are spelled out (e.g., sales price or mortgage amount, relevant terms, etc.);
- determine who has been authorized to sign on behalf of the corporation. Consider whether the state statute may provide limitations on who can be authorized or whether certain attestation is necessary.

When shareholder consent is required, you must:

- review the evidence of required consent;
  confirm that the voting shareholders have been notified of the details of the transaction.

Execution by proper offices
The statute, the articles, and resolutions, whether they are by the board of directors or the shareholders, should all be reviewed to determine the identity and propriety of the designated signatory. The signatory should describe their status (e.g., vice-president or secretary) according to the appropriate authorization.

Corporate seal
Conveyances, mortgages, leases and even resolutions (see above) should be "under corporate seal" if such is required or contemplated by the law of the state of incorporation. Even if not so required, it may be necessary for a document to be sealed in order to get recorded in your state.

Use of statutory requirement of impressed seals is decreasing, but you should determine what is required in your state.

Verification of Signatures
In order to independently verify the authenticity of signatures on a document that has been recorded on the land records or that has been submitted to you, there are a number of actions you might take. You might require the signatures on the document to be notarized in accordance with the Company's document execution guidelines. If the entity has counsel, you might require the entity's counsel to verify the signatures. If there is a key signature or a number of random signatures that you want to verify, obtain the phone number or email address of the signatories from a source other than the party that you are dealing with, and contact those signatories.

Independently verify the authenticity of a recent amendment or other document with the entity's counsel or by telephoning the manager of the closely held corporation.

Red Flags
You should consider and follow all current guidelines published by the Company on this topic.

When a transaction involves a conveyance or a financing by a corporation all authority documents must be reviewed.

If the following RED FLAGS appear as part of your transaction, you must seek approval of Company underwriting advisor.

- A recent change in the state filings of the entity that adds or deletes parties with authority or a change in the bylaws that attempts to do the same.
- Any transaction that involves conveyancing or mortgaging of Land by or to an officer or affiliate of the corporation.
- Foreign Executions - When Directors or other entity officials are not located in the United States or the corporate documents reveal the owners are not located in the United States, their signatures are to be acknowledged pursuant to our foreign notarial guidelines, including compliance with the terms of the Hague Convention, if applicable. All signatures on consents and resolutions must be notarized accordingly. Any variation from this practice must be approved in writing by your Company underwriting advisor.
- Any variation in name, no matter how minor, in chain of title or the documentation submitted to support the chain of title.
- Any recent conveyance without corresponding financing.

Corporations

Not-for-Profit Corporations

A NOT-FOR-PROFIT CORPORATION IS GENERALLY FORMED FOR SOME RELIGIOUS, CHARITABLE, EDUCATIONAL OR SOCIAL PURPOSE AND DOES NOT CONTEMPLATE THE DISTRIBUTION OF PROFITS TO ITS MEMBERS. YOU SHOULD CONSIDER THE MATERIAL IN SECTIONS I AND II, AS THE ISSUES INVOLVED ARE NOT UNLIKE THOSE OF BUSINESS CORPORATIONS. A MORTGAGE OR CONVEYANCE OF ***SUBSTANTIALLY ALL OF THE NOT-FOR-PROFIT CORPORATION'S ASSETS*** *MAY REQUIRE THE APPROVAL OF THE MEMBERS.*

General

You should review the articles of incorporation and by-laws of the not-for-profit corporation. Be sure to confirm that these and the state statute allow the corporation to deal with title to real estate. Determine that the corporation is in good standing.

Previous Sections

You should consider Section Corporations 1 and 2 herein. Be sure that the terms of the transaction are spelled out with particularity in any required notices to members.

Corporations

Religious Corporations

RELIGIOUS CORPORATIONS WILL HAVE REQUIREMENTS CONTAINED IN DOCUMENTS WHICH MAY EXCEED A SET OF BYLAWS OR ARTICLES OF INCORPORATION. THESE MAY BE RULES OR OTHER FORMS WHICH YOU MUST OBTAIN AND REVIEW. YOU MUST DETERMINE STRICT COMPLI-ANCE WITH ANY REQUIREMENTS.

General

You must review the bylaws, rules, orders for whatever requirements are to be followed in order for the religious corporation to sell, mortgage or lease the land. You must ascertain compliance.

Meeting which approved this transaction

Special care should be given to a review of the record of the meeting at which the insured transaction was approved. Obtain from the proper corporate office the names of all persons elected members of the Board of Trustees, deacons, etc. at the last election. Consider the form of the election and that elected officials continue to be qualified. Determine the number of members or trustees entitled to vote on corporate matters and the number of approving votes cast.

Determine that proper notice of the meeting was given to all members. Obtain a copy of the resolution adopted by the members authorizing the transaction. Be sure that the details of your transaction have been described in the resolution.

Unincorporated Religious Association

An unincorporated association is a fictional non-entity not distinguishable from the members comprising it, and in the absence of authorizing statutes, it is incapable of acquiring, holding or contracting with respect to real property.

It is not uncommon for a religious association, with no legal status, to attempt to take title in the name of the association alone. Such an attempted transfer will not vest title in the association, since as an unincorporated religious association; it is generally not a legal entity in which legal title can vest. Solution: It may be possible to take title in the names of the trustees of the association. Any deed to the trustees of the association should recite the powers with respect to dealing with the property. It should also reference the bylaws or other governing documents. Failure to so recite and reference will result in extra measures being needed to determine such powers and authenticity of documents of governance.

Corporations

Publicly Regulated Corporations

PUBLIC UTILITIES, INTERSTATE CARRIERS, BANKS, SAVINGS AND LOAN ASSOCIATIONS, INSURANCE COMPANIES, RAILROADS AND SIMILAR CORPORATIONS ARE UNDER THE JURISDICTION OF A STATE OR FEDERAL AGENCY AND THE CONSENT OF SUCH AN AGENCY MAY BE REQUIRED BEFORE A VALID DEED, MORTGAGE OR LEASE MAY BE MADE. YOU MUST ASCERTAIN THAT THE CORPORATION HAS THE STATUTORY AUTHORITY FOR THE SPECIFIC TRANSACTION.

National Banks

National banks are restricted as to their acquisition of real property.

The National Bank Act, 12 U.S.C.29, contains express provisions relative to the powers of national banks in regard to real estate, and the purposes for which such banks may purchase and hold realty are expressly limited and specifically set forth. A national bank may purchase and hold real property for the following purposes only:

a. It's necessary for the bank's accommodation in the transaction of its business;
b. To be mortgaged to the bank in good faith by way of security for debts previously contracted;
c. To be conveyed to the bank in satisfaction of debts previously contracted in the course of its dealings;
d. To purchase at sales under judgments, decrees or mortgages held by, or to secure debts due in favor of, the bank.

Real estate held by a national bank under the above paragraphs b, c and d may be held for a five-year period, but this period may be extended for an additional period of five years if the extension is approved by the Comptroller of the Currency.

Railroad Corporations

Refer to separate Sections on Railroads. Approvals formerly required of the Interstate Commerce Commission are now to be obtained from the Department of Transportation, Surface Transportation Board. This may not apply to abandonment procedures.

Motor Carriers

The consolidation or merger of two or more carriers; the purchase**,** lease, or contract to operate property of a carrier by one or more carriers; and certain transactions resulting in control of a carrier, all require the approval of the Surface Transportation Board (49 U.S.C. 11324). In addition, "if a purchase and sale, a lease, or a corporate consolidation or merger is involved in the transaction, the carrier or corporation may carry out the transaction only with the assent of a majority, or the number required under applicable state law, of the votes of the holders of the capital stock of that corporation entitled to vote" (49 U.S.C. 11341).

If title has, within one year of the date of policy, fallen within one of the above described transactions, require evidence of approval by the Surface Transportation Board, as well as the shareholders, unless the transaction is shown to be exempt.

Creditors' Rights

CREDITORS' RIGHTS COVERAGE IS NO LONGER AVAILABLE. ALTA HAS WITHDRAWN THE ALTA 21-06 ENDORSMENT AND THE COMPANY WILL NOT ISSUE ANY SUCH COVERAGE.

THE FOLLOWING DISCUSSION IS FOR BACKGROUND PURPOSES ONLY.

Background

In late 1980, the title industry experienced a number of claims by which losses were suffered which centered around the powers of bankruptcy trustees and courts to set aside transactions because they adversely affected creditors of the debtor. These losses occurred even though the title companies that had issued the policies had not anticipated that the coverage included such a loss, either on the assumption that the purchaser and/or lender insured was a bona fide purchaser for value, or that the matter at issue was excluded as a matter assumed or as an act of the insured.

With the rude awakening that these cases brought, the American Land Title Association decided in 1990 to add a broad Exclusion to its policies to clarify that the risk was not intended to be within coverage. A subsequent modification of the Exclusion language was implemented in 1992.

The risk that gave rise to the concern was in the application of sections 547 and 548 of the Federal Bankruptcy Code. Additional exposure exists under state laws in the form of state enactment of the Uniform Fraudulent Transfer Act (UFTA) or the Uniform Fraudulent Conveyancing Act (UFCA). These may be enforced either independently or in bankruptcy. Statutes of limitation vary from state to state, some extending as long as ten years.

The Risks

Section 547 of the Bankruptcy Code is known as the "Preference" section. A preference occurs when a creditor is adversely affected through an action which gives better security to another creditor. An example would be where the holder of an unsecured note is later given a lien on the land of the debtor through the use of a mortgage. The holder of the mortgage would typically be paid off first or to a greater extent than an unsecured note holder. There is a limitation on the application of this section to transactions occurring within ninety days of the filing of the bankruptcy. Where the secured party is deemed to be an insider, the limitation period is extended to one year. A condition is that the debtor is insolvent at the time of the preferential transfer.

Where a preference occurs and action is taken within the applicable limitation period, the transaction may be voided. In the example just given, the holder of the mortgage lien no longer may use the priority given by the mortgage to the detriment of unsecured creditors.

Section 548 of the Bankruptcy Code deals with fraudulent conveyances. Transfers may be avoided as fraudulent if:

1. consideration is for less than reasonably equivalent value,
2. there is intent to adversely affect creditors,
3. the debtor
   a. was insolvent, or
   b. was rendered insolvent by the transaction, or
   c. was rendered unable to repay debts, or

d. was left with unreasonably small working capital.

Under the Bankruptcy Code, fraudulent transfers may be voided if made within one year of the bankruptcy filing. However, bankruptcy trustees may also act under Section 546(b) to enforce state laws, especially either the UFCA or the UFTA. These usually have much longer limitation periods, extending up to ten years.

Further, under the Code, both those whose claims arose before the fraudulent transfer, as well as those whose claims arose after it, can benefit.

Any creditor may avail itself of these state laws. The results from a title standpoint can be just as devastating.

Title Industry Response

In April of 2004 ALTA adopted the ALTA 21-06 (Creditors' Rights) endorsement which affirmatively insured against loss created by the transaction creating the interest insured being set aside in bankruptcy as a fraudulent conveyance or preference. ALTA subsequently withdrew the coverage in March of 2010. The Company had previously indicated its unwillingness to issue the ALTA 21-06.

Creditors' Rights

Antecedent Debt Exception

WHENEVER YOU ARE ASKED TO RECORD AND INSURE A NEW MORTGAGE THAT DOES NOT SECURE A CONTEPORANEOUS FUNDING, YOU SHOULD BE AWARE OF CREDITORS' RIGHTS ISSUES.

Issuing a Policy
The 2006 ALTA Loan Policy insures against loss or damage by reason of a preference created by the failure of the Insured Mortgage to be recorded "timely". Covered Risk 13 (b) (i) provides coverage against:

13. The invalidity, unenforceability, lack of priority, or avoidance of the lien of the Insured Mortgage upon the Title…(b) because the Insured Mortgage constitutes a preferential transfer under federal bankruptcy, state insolvency, or similar creditors' rights laws by reason of the failure of its recording in the Public Records (i) to be timely, …

The following scenario raises creditors' rights issues. We are asked by a lender to record and insure a new mortgage that did not secure a contemporaneous funding. The loan had funded several months ago. The mortgage contained a clause that it was to be effective as of that previous funding date. Consequently, the new mortgage could not be recorded within 30 days from its funding, a safe harbour provision of the bankruptcy code to avoid a preference issue regarding "antecedent debt". We were not willing to issue a policy which afforded the coverage highlighted in Covered Risk (b) (i) above. If you are requested to issue a 2006 Loan Policy on a mortgage which secures debt funded over 30 days prior to the mortgage recording, please include the following exception in the policy:

> *The invalidity, unenforceability, lack of priority, or avoidance of the lien of the Insured Mortgage to secure an antecedent debt if the Insured Mortgage constitutes a preferential transfer under federal bankruptcy, state insolvency, or similar creditors' rights laws.*

Recording a Document
With respect to recording, when you receive documents for recording that you know secure debt which has not contemporaneously funded, be sure to present these for

recording in a timely manner, i.e., within 30 days of the funding. This will enable the insured mortgagee to obtain the protection of the 30-day safe harbour provision against a preferential transfer provided by the bankruptcy code. If you know that the non-contemporaneously funded secured debt was funded over 30 days prior, present the documents for recording ASAP (and include the above exception in the mortgagee policy). This recording begins the 90-day vulnerability period for non-insider lenders during which a mortgagor bankruptcy risks a preferential avoidance action. If you know that the non-contemporaneously funded secured debt funded within 30 days of your receipt of the documents, depending upon the timing of your receipt of the documents, you may have to alert your mortgagee customer that the above exception will be included in its policy. And, of course, make sure that any documents that you receive for recording in contemporaneously funded transactions are presented for recording within 30 days of funding as well.

D'OENCH DUHME DOCTRINE

FDIC and failed Lending institutions

THE D'OENCH DUHME DOCTRINE MUST BE CONSIDERED IN THE CONTEXTS OF MORTGAGE ASSIGNMENTS, BANK INDEMNITIES AND BANK POWERS OF ATTORNEY.

The long-standing "D'Oench Duhme doctrine" (referring to the U.S. Supreme Court case in 1942), was last utilized extensively in the savings and loan crisis of the 1980s and 90s. The doctrine provides the following: the FDIC, when it becomes Receiver of a federally insured bank, is **not** bound by any agreement between a borrower and the bank unless it was (1) in writing, (2) executed by the bank contemporaneously with the loan or a loan modification, (3) *approved by the board of directors or its loan committee and reflected in the minutes of said committee*, and (4) had been continuously an official record of the bank—that is to say the agreement was *in the file* when the FDIC took over. Basically, this means that if the borrower had some handshake or other personal agreement with someone at the bank or, even if more formally approved, evidence of it was not in the file, it would not be enforceable against the FDIC. It is raised as a defense against the enforcement of the lien such as in a foreclosure action or bankruptcy.

It needs to be considered in at least three contexts for title insurance purposes:

(a) the consequences of the absence of borrower estoppel statements on insured loan assignments,

(b) indemnifications running to us from federally insured lending institutions, and

(c) insurance based on powers of attorney granted by the failed bank but sought to be exercised after FDIC receivership.

Assignments of mortgages
When asked to insure an assignment from the FDIC as receiver, we call for a written estoppel statement from the loan borrower or for some effective indemnification from the FDIC. However,

you may receive an argument from the FDIC that neither of those is necessary, based on the assertion that D'Oench Duhme would preclude any borrower defenses being raised. But, in fact, the FDIC's own Statements of Policy question whether the doctrine could be asserted in a situation where the borrower had paid the loan off and had cancelled checks to prove it, yet nothing like that was in the bank's file. If the FDIC will not provide anything with respect to borrower defenses, you must raise a Schedule B exception for rights relating to the loan which would be disclosed by making inquiry of the borrower. For our standard procedures, see Section Assignment of Mortgages 1 in this manual.

Indemnities

Another important application of D'Oench Duhme is the need to be sure that any indemnification from a federally insured bank has been executed pursuant to proper bank resolutions by the Board of Directors. Without such resolutions, the FDIC might have the ability to assert the doctrine to deny the indemnification. While it is always appropriate to be sure that indemnifications from business entities are properly authorized and executed, it is especially so where the indemnitor's obligation may be impacted by application of the D'Oench Duhme doctrine.

Powers of attorney

With the large number of lenders who have become bankruptcy debtors, we have seen some instances involving powers of attorney granted by those lenders pre-petition, but which we are told will be exercised post-petition. Often, the power of attorney relates to servicing agreement rights which the debtor sold pre-petition. Sometimes the power will be exercised to convey a piece of real estate that has become REO held of record by the debtor. The problem for us is that contracts of agency are revoked by law upon bankruptcy, unless that contract, such as a power of attorney, is coupled with an interest in the holder which is superior to that of the bankruptcy trustee. Since the trustee is vested with all of the rights of a bona purchaser for value without notice, the holder of the power may find it difficult to successfully assert such a coupled interest. Accordingly, it is prudent for us to require that the power of attorney be ratified post-petition.

When the FDIC has taken over a bank that had granted a power of attorney which has not been exercised as of the date of receivership, it is possible that the holder of the power may assert that their power is coupled with an interest, such as assignment of servicing rights or an interest in the loan itself. Nonetheless, it is prudent to have the FDIC ratify or re-grant the power to avoid any claim that the power has been revoked or terminated by the receivership.

Easements

Easements as Exceptions

ANY EASEMENT OVER, UNDER, ON OR ACROSS THE LAND MUST BE SHOWN AS AN EXCEPTION IN SCHEDULE B. THE EXCEPTION SHOULD DESCRIBE THE PURPOSE OF THE EASEMENT, THE MANNER IN WHICH IT WAS CREATED AND THE EXACT PART OF THE LAND WHICH IS AFFECTED OR BURDENED BY THE EASEMENT.

General

An easement is the right to use the land of another and may be granted for such purposes as access, driveway, party wall, drainage, public utility and other purposes. You must raise an exception for any easement which burdens the land. An easement may be revealed by a recorded instrument such as a deed, grant, contract, mortgage, lease, plat, declaration of covenants and restrictions, or declaration of easements. Further, the existence of an easement may be disclosed on a survey, from an inspection of the land, information from the application, or from your own knowledge.

Form of Exception

ALTA has adopted standard form exceptions for use on ALTA Loan Policies. You will note that they do not provide for description of the purpose of the easement. That is because they are suggested for use where one-to-four family residence properties are secured by the insured loan. They are intended to promote a prompt and efficient review of the Schedule B exceptions by lenders. They are **not** designed for use in commercial transactions.

For non-residential transactions, including where the land is vacant, you should simply and concisely state the purpose of the easement. If this is not possible, recite that the easement is "*for the purposes described in that instrument.*" If the instrument fails to describe the exact location of the easement, disclose that in the exception, e.g., "*the instrument does not describe the exact part of the land affected by the easement*."

Non-Record Easements (Disclosed by survey or inspection)

You must reflect apparent easements shown by surveys or inspections of the land. When showing these on Schedule B, do not describe the usage with precision, but rather, have the exception read rather broadly like in this example:

> *Easement shown by the survey by (name), dated _____, apparently being for driveway purposes and apparently affecting the east 10 feet of the land.*

Note on survey reading: Utility conduits (wires, pipes, cables, etc.) which service the land need not be shown as exceptions. However, when these conduits traverse the land and service other properties, an exception must be raised. Be careful on properties with large paved parking areas, such as shopping centers, to reflect possible easements reflected by sewer grates, manholes, hydrants and the like.

Special cases

A non-apparent easement you may encounter involves property which includes a beach or similar **recreation area**. The public may have an implied easement for use. A pathway or other physical evidence may not exist. If the land has a beach or other evidence of public rights, raise "*right of access, if any, of the public over and across the land to (body of water or other public site).*"

Another easement which may not be apparent from a survey is a **drainage easement.** Consider the possibility of drainage easements where the land is unsubdivided, or very recently subdivided without improvements. Unless you are satisfied that no such easements exist, if you omit General Exception 3, you should show: "*right of way for drainage ditches, feeders, laterals or underground drain pipes, if any.*"

Termination

An easement may be removed or omitted as an exception only if you are satisfied from an inspection or comparable evidence that the easement was never used or has ceased being used for a reasonably safe period. Any period under 6 months should be discussed with the Company's underwriting adviser. In addition, the easement must have been terminated by (1) voluntary release, (2) merger, (3) exercise of a superior right or lien, (4) occurrence of some event specified in the grant, or (5) judicial decree of abandonment. Any other basis must be referred to your Company underwriting adviser.

Voluntary release must be by a recorded instrument executed by all persons having a right in or a lien on the land benefited by the easement. This will require you to examine title to the benefited land.

Merger may apply to terminate an easement by reason of the ownership of the benefit being acquired by the owner of the burdened land, provided all parties having an interest in the benefited land consent. However, merger is almost always under state law a question of intent and you must require such intent to be clearly stated by the acquiring owner in writing.

Exercise of a superior right or lien requires you to be sure that the right or lien is in fact superior. Prior recording may not be sufficient if consent or subordination is evidenced.

Abandonment as a basis for waiver or omission of an easement requires special attention. It must be established by a final non-appealable order by a court of competent jurisdiction to which all parties having an interest in the benefited land are parties.

Easements

Underground Utility Conduits

DO NOT DELETE GENERAL EXCEPTION 3 (EASEMENTS OR CLAIMS OF EASEMENT NOT DISCLOSED BY THE PUBLIC RECORDS) UNTIL YOU ARE SATISFIED THAT THERE ARE NOT SUBSURFACE CONDUITS (WIRES, PIPES, CABLES, ETC.) ACROSS THE LAND.

General

While surface indications, such as manholes or ventilation grates, may be disclosed by a survey or inspection, presence on the land of underground utility conduits is often not apparent.

When you are asked to delete General Exception 3, or the general survey exception, on the basis of a satisfactory survey and physical inspection, you should consider the nature of the land being insured with relation to the possibility of these conduits. If, for example, the land is a part of a newly platted subdivision where all of the utilities have been installed by the subdivider, either in the streets or in easements reserved for such purposes by instruments of record, the possibility of such conduits is slight. If, however, the land is located in an older section, particularly a commercial section, where the buildings on surrounding lands have been in existence for some time, there is a much greater possibility. Probably the greatest risk exists when the land includes a vacated street or alley or part thereof.

Although it is always possible that the conduits might be for the transportation of oil or similar products, usually they are for public utilities serving the land in the immediate vicinity. If you believe that there is a reasonable probability that these conduits might exist, you should require proof from the municipal engineers' records and the records of the public utilities serving the area that they have no conduits crossing the land.

A reasonable probability of such conduits also might exist when the owner of a larger tract, on which improvements have been in existence and have been occupied for some time, starts to sell off vacant parts of the tract. In this situation you should require proof as to the location of all of the utility lines which serve the existing improvements, to be certain that none cross the vacant areas which are to be described in the title policy.

Easements

Insurance of an Easement

THE OWNERSHIP OF AN APPURTENANT EASEMENT IS AN ESTATE WHICH CAN BE INSURED IN A TITLE POLICY PROVIDED THE OWNERSHIP OF THE BENEFITED LAND IS ALSO BEING INSURED IN THAT SAME POLICY. BEFORE DOING SO, HOWEVER, YOU MUST EXAMINE THE TITLE TO THE LAND AFFECTED BY THE EASEMENT TO DETERMINE THAT THE EASEMENT WAS VALIDLY GRANTED, AND MAKE AN INSPECTION OF THAT LAND, TO BE CERTAIN THAT THE EASEMENT IS IN USE.

The ownership of an appurtenant easement (one which runs with the title to the land which it benefits) can be insured in a title policy which also insures the ownership of the land which it benefits. Similarly, the validity and priority of a mortgage on the ownership of an appurtenant easement can be insured in a policy which also insures the validity and priority of the same mortgage on the benefited land.

Since insuring the ownership of an easement requires an additional examination, for which an additional charge may be made, ascertain from the customer as soon as possible whether the easement is to be insured. If it is not, call attention in the commitment to the existence of the easement with the statement that the ownership will not be insured by the policy.

If the easement is to be insured, then show in Schedule A as Parcel 1 the description of the benefited land and as Parcel 2 the following:

> *Easement for the benefit of Parcel 1 as created by (**the type of instrument which constitutes the easement grant**) dated __________ and recorded ____________ as Document No. ____________ for **(state the purpose of the easement**) over, under and across the land described as follows: (**here describe the easement premises**). Subject to the terms, provisions and conditions set forth in said instrument.*

If you cannot state the purpose in the exact language used in the easement grant or in similar language which does not imply a greater purpose than that used in the easement grant, then use in the above language for the purpose of the easement the phrase *“For the purposes described in that easement”.*

If you insure an easement in Schedule A, there should always be a corresponding exception for the terms and conditions of that easement in Schedule B, even if the “subject to” language is included in the description in Schedule A. The lead in language in Schedule B clarifies that we are not covering any challenges to the extent of use of the easement, which is very helpful in claims situations.

If the exact location on the ground is not ascertainable from the grant of easement, an exception should be raised as to this issue

If the easement is not open and in use, or that determination cannot be made, an exception should be raised as to this issue.

Easements

Easements in Gross

AN EASEMENT IN GROSS IS NOT APPURTENANT TO ANY LAND. UNDER THE LAW OF SOME STATES IF AN EASEMENT IS NOT APPURTENANT TO OTHER LAND IT MAY NOT BE ASSIGNABLE. A RIGHT THAT IS NOT ASSIGNABLE CANNOT BE INSURED.

General

Where an easement is not assignable or inheritable, it cannot extend beyond the life of the grantee. Sometimes such a right is characterized as a **license**, although not always designated as such. A personal right to use the land of another which is not alienable is **not insurable**.

State law may declare that specific easement rights, although easements in gross, are nonetheless interests in real property. They may at law be assignable. Required language for assignability should be ascertained. Often the grant must be shown to run to "successors and assigns" of grantor and grantee. Commercial easements in gross, such as for utility conduits or advertising space, are more likely to receive special treatment under state law. Any request to insure an easement in gross must be referred to your Company underwriting advisor for a determination of the insurability in your state.

Special Aspects

Besides consideration of state law with respect to whether an easement in gross in real property, you must consider issues such as **access** to the easement and **exclusivity** or lack thereof and raise appropriate exceptions. Any lack of specificity of the means and location of access must be raised.

Licenses

A license is not an interest in real property but merely confers on the licensee a personal privilege to do some act on the land. A license is not insurable. A license burdening the land, however, must be shown as an Exception on Schedule B. It may be waived when it has expired by its terms or has been revoked <u>and</u> the licensee has surrendered possession to the licensor.

Federal Revenue Liens

General Tax Liens

YOU MUST SEARCH FOR AND SHOW AS AN EXCEPTION/REQUIREMENT IN ANY TITLE POLICY/COMMITMENT/TITLE REPORT ANY NOTICE OF FEDERAL TAX LIEN (A) WHICH HAS BEEN FILED FOR RECORD IN THE OFFICE DESIGNATED FOR SUCH FILING IN THE RECORDING AREA IN WHICH THE LAND IS LOCATED, (B) WHICH AFFECTS THE ESTATE OR INTEREST DESCRIBED IN THE POLICY/COMMITMENT/TITLE REPORT, AND (C) WHICH HAS NOT BEEN TERMINATED BY ACT OF THE UNITED STATES, BECOME INEFFECTIVE BY LAPSE OF TIME, OR ELIMINATED BY THE ENFORCEMENT OF A PRIOR LIEN.

General
Although a tax lien arises as of the date of the assessment of the tax, it is not effective as to a purchaser, the holder of a security interest, or a judgment lien creditor until a notice of the tax lien has been made a matter of public record (the records which show the assessment of the tax are not available for public inspection and search). There are also certain other persons, estates or interests which may not be affected by the tax lien, even if a notice has been filed for record, but such persons and the owners of these estates or interests usually are not the insureds in our title insurance policies. The instructions and procedures which follow, consequently, are limited to those situations in which you are issuing an owner's policy on the estates or interests which may be insured or a loan policy insuring the validity/enforceability of a mortgage on such estates or interests. For these purposes, you need not be concerned with actual notice of a tax lien when the notice of the lien has not been properly filed for record.

Search and Reporting Procedures
Search for federal tax liens in the Recorder's Office for the area in which the land is located, provided your state has enacted legislation which permits the recording of federal tax lien notices in that office; otherwise your search must be made in the office of the Clerk of the United States District Court for the district where the land is located.

Search all names in the chain of title for the same period you search such names for state court judgments but your search for federal tax liens must be for a period not less than eleven years prior to the date of your search or for the period during which the vendor or mortgagor has been the owner of the estate or interest, if such period is longer than eleven years.

1. Although a notice of tax lien is effective only for a period of ten years and thirty days from the date of assessment, unless it is refiled within the last year of the ten-year, thirty-day period, the period may be extended if the land was the subject matter of a suit to which the United States was a party during the period, or if the United States made a levy on the land during the period. Since neither the suit nor the levy might be disclosed by your ordinary search, we have selected eleven years as the period of search, taking a business risk as to notices which are not disclosed within that period. Note, however, that if the ten-year, thirty-day period expired before the taxpayer acquired ownership and no refiling has occurred, you need not show the tax lien, since the land would not be the subject of a suit or a levy before the taxpayer acquired ownership. In the event of an extension, the lien remains effective for ten years from the expiration date of the proceeding period. An indefinite number or successive filings is permitted.

2. Do not omit, however, any other notice disclosed by your search which appears to have become ineffective because of the lapse of the ten-year, thirty-day period (or the ten-year period in the case of a refiling) without the approval of your Company underwriting advisor, who will take into consideration the amount of the lien, the age of the notice and the probability of attempted enforcement in giving approval for the omission.

A federal tax lien is effective as to estates or interests in personal property for the same period or extended period as one affecting an estate or interest in land but the place for filing the notice varies. The situs of personal property, whether tangible or intangible, is at the residence of its owner at the time the notice of the lien is filed. If that situs is within a state which has prescribed a single office for filing notices of federal tax liens, the notice is to be filed in that office; if the state has not prescribed such an office, then it must be filed with the clerk for the United States District Court for the district in which such residence exists. The residence of a corporation or partnership is defined as being the state in which it has its principal executive office. If the owner of the estate or interest, whether an individual, a corporation or a partnership, is not a resident of the United States, then the place for filing is the Recorder's Office for the District of Columbia.

Ordinarily, you will not be required to make a search for federal tax liens affecting personal property but in two instances you may be required to do so. The first is when you are required to determine that there are no federal tax liens against the assignor of a mortgage when we are issuing or endorsing a mortgage policy which insures the validity of the assignment. The second instance is where it is necessary to determine that there are no federal tax liens against the assignor of a tenant's interest in a cooperative.

Estates and Interests Affected

1. After acquired property - The lien attaches to the estate or interest as soon as it is acquired.

2. Homestead - The lien can be enforced even though a homestead exemption is claimed under state law.

3. Tenancies in common - The lien attaches to the undivided interest owned by the taxpayer and may be enforced by a sale of all of the undivided interest, with the owners of the undivided interest, to which the lien did not attach, being required to accept their proportionate part of the amount available from the proceeds of the sale.

4. Joint tenancies - The lien attaches to the interest of a taxpayer-tenant and can be enforced by a sale of all interests with distribution of the proceeds to the others in interest or by a sale of the interest of the taxpayer-tenant which will create a severance; it may survive the death of the taxpayer-tenant.

5. Tenancies by the entirety - The tax lien attaches to the interest of the taxpayer-tenant. (*United States v. Craft* , 2002 WL 561332)

6. Community property - The tax lien attaches to the one-half interest owned by the spouse named in the notice of tax lien (taxpayer), even though the record title is in the spouse not named in the tax lien (non-taxpayer). Searches for tax liens, consequently, should be made against the names of both spouses. The tax lien is neither affected by the death of the taxpayer nor by a

conveyance of the entire property joined in by both spouses. The lien may be enforced by a sale of the entire property, requiring the non-taxpayer to accept one-half of the net proceeds of the sale.

7. <u>Leasehold estate</u> - A notice of tax lien filed against the lessor after the creation of the leasehold estate will not affect the estate of the lessee but you should not insure the interest of the lessee after an option to renew has been exercised if a notice of tax lien has been filed against the lessor before the exercise of the option. A tax lien against the lessee attaches to his leasehold estate and a notice of the lien will survive a surrender of the estate or its assignment. As to proprietary leases in a cooperative, you must search for tax liens against the lessee in the land records.

8. <u>Vendee's interest in an installment land contract</u> - If a contract is recorded or the contract purchaser has entered into possession, his interest is not affected by a notice of tax lien thereafter filed against the vendor. You should consult your Company underwriting advisor, nevertheless, before issuing a policy in favor of the contract purchaser after he has received a deed from the vendor or before issuing a policy to an assignee of the vendee if there has been an intervening tax lien notice in either case. A tax lien filed against the vendee attaches to the vendee's interest and a notice filed in the land records will survive the surrender or assignment of the vendee's interest.

9. <u>Options and executory contracts to purchase or to lease</u> - Although these are given special priority status, you should not issue a policy which insures the validity or priority of these interests. A notice of tax lien filed against the land owner after the grant of the option or execution of the executory contract must be disposed of before you insure the ownership of the estate or interest acquired by exercise of the option or performance of the contract.

10. <u>Delayed disbursements in mortgage transactions</u> - Although obligatory future advances, construction loan disbursements, and disbursements under a commercial financing agreement may have priority over a notice of tax lien filed between the recording of the mortgage and the subsequent disbursement, you should not down-date a policy to cover a period after the initial recording and

insure over an intervening tax lien unless (a) you have obtained proof that the entire mortgage proceeds were disbursed before the notice was filed, or (b) you have obtained the approval of your Company underwriting adviser.

In order for a purchaser or a holder of a security interest to have priority over a tax lien, the interest of the purchaser or holder of the security interest must have been made a matter of record, or otherwise established, so as to be protected under state law against a subsequent judgment lien arising out of an unsecured obligation.

- For your purposes, a deed, lease, installment contract to purchase or mortgage must have been recorded and the proceeds of the mortgage fully disbursed before the notice of tax lien is recorded.

While actual notice of a tax lien, without a filed notice, will not affect the rights of a purchaser or the holder of a security interest, a purported interest acquired as a part of a scheme between the taxpayer and the purchaser/mortgagee to evade collection of the tax will not be protected.

1. In most instances, the intent of the purchaser or mortgagee will not be communicated to you and, if no record notice of such intent appears, we will have a policy defense.

2. You should not, however, omit, from a title policy issued in favor of a surviving tenant by the entirety, a tax lien against the deceased tenant if the lien arose (that is, the tax was assessed) before the estate was acquired by the entirety even though the notice of the lien had not been filed for record at the date of such acquisition. This factor must also be taken into consideration in determining whether a tax lien against a deceased joint tenant can be omitted when title is being derived from a surviving joint tenant.

Termination of a Tax Lien

A tax lien may be eliminated, insofar as the estate or interest described in the policy is concerned, by reason of the United States issuing any of the following, which then must be filed for record:

1. A certificate of release, issued if the tax has been paid, has become legally unenforceable, or a satisfactory bond has been furnished to insure payment of the tax.

2. A certificate of discharge, issued as to a specific parcel of land if other land is adequate to pay the tax, a part payment of the tax is made in return for the discharge, the interest in the land is discharged by reason of the land being valueless, or to permit sale if the tax lien is being transferred, in effect, to the proceeds of the sale.

3. A certificate of subordination issued if monies are paid to the United States, or if the interest to which subordination is being made will have the effect of increasing the security or collectability of the lien. The issuance of a certificate of subordination, however, does not eliminate the necessity for showing the tax lien in the policy even though you may be prepared to insure specifically that the tax lien is inferior to the mortgage described in Schedule A.

4. A certificate of non-attachment, issued to clarify confusion as to the identity of the person affected by the lien.

The tax lien may be eliminated if the notice has lost its effectiveness because of lapse of time.

- Follow the instructions given relative to considering any notice to be effective for an eleven-year period and of discussing with your Company underwriting advisor the waiver or elimination of any disclosed notice of tax lien which appears to have become ineffective by reason of lapse of time.

The tax lien may be eliminated by a final, non-appealable decree of a court of competent jurisdiction in a suit to quiet title, a partition suit, a condemnation suit or a suit in the nature of an interpleader, if the United States has been made a party defendant and has been properly served under Rule 47 of the Federal Rules of Civil Procedure. This process includes the following steps:

1. A copy of the summons and complaint must be delivered to the U.S. Attorney for the district where the action is brought or his/her designee or a copy of each must be sent by registered or certified mail **and** the summons and complaint must also be mailed by registered or certified mail to the Attorney General in Washington, D.C.

2. The complaint should include the name and address of the taxpayer whose liability created the lien in favor of the United States and, if a notice of tax lien was filed, the identity of the internal revenue office which filed the notice, and the date and place such notice of lien was filed.

The tax lien may be eliminated by the enforcement of a superior lien either through judicial process, execution sale or by the exercise of a power of sale, but there must be a sale. A decree of strict foreclosure, for example, in a mortgage foreclosure, is not adequate.

1. If by judicial process, the United States must be made a party defendant if the notice of tax lien has been filed of record more than 30 days prior to the date of the filing of the complaint, in which event service of process must be made on the United States. If by execution sale or by exercise of a power of sale, the United States must be given notice of the sale not less than 25 days before the sale if the notice of tax lien was filed more than 30 days before the sale.

(a) Notice of the sale is to be addressed to the District Director for the IRS for the district in which the sale is to be conducted, marked to the attention of the Chief, Special Procedures Section and should set forth:

(1) the name and address of the person submitting the notice of sale;

(2) a copy of each notice of federal tax lien (Form 668) affecting the land to be sold or in lieu thereof the Internal Revenue District named therein, the name and address of the taxpayer, and the date and place of filing of the notice;

(3) a detailed description of the land to be sold showing also the street address, city and

state "and, if available, a copy of the abstract of title."

(4) the date, time, place and terms of the proposed sale; and

(5) the approximate amount of the principal obligation including interest, secured by the lien sought to be enforced and a description of the other expenses (such as legal expenses, selling costs, etc.) which may be charged against the sale proceeds.

(b) While the aforesaid notice may be accomplished by personal service, not less than 25 days prior to such sale, it may also be accomplished by a registered or certified letter addressed as above provided. The IRS Regulations provide that in the case of a letter, the date of the postmark will be considered to be the date of the notice.

(c) When the sale is postponed, notice of the new date of sale must be given to the United States not less than 25 days prior to such sale, by the methods prescribed by your state law for giving notice to those having a lien interest which would be divested by the sale. The notice must be addressed to the District Director in the same manner as in the original notice of sale.

2. Regardless of whether the sale is pursuant to judicial process, execution sale, or by exercise of a power of sale, the United States has the right to redeem within 120 days from the date of the sale unless a longer period of redemption is specified by the applicable state law, in which event the United States has the right to redeem for such longer period.

Federal Revenue Liens

Insuring Title Coming Through Levy and Sale Under Federal Tax Lien

LEVY AND SALE UNDER A FEDERAL TAX LIEN IS GOVERNED BY THE PROCEDURE ESTABLISHED IN 26 USC 6331 ET SEQ. IF THE PROCEDURE IS CORRECTLY FOLLOWED AND PROPER DOCUMENTATION IS OFFERED, AN INSURABLE TITLE CAN RESULT. HOWEVER, THESE TITLES INVOLVE SPECIAL RISKS, AND SHOULD BE INSURED ONLY IN CONFORMITY WITH THESE GUIDELINES. AUTHORITY TO ISSUE ANY SUCH COVERAGE MUST BE OBTAINED FROM YOUR COMPANY UNDERWRITING ADVISOR.

Levy and sale under a general federal tax lien, if properly done, will result in a marketable title in the purchaser, and will cut out the title of the taxpayer and all liens and interests in the land perfected subsequently to the filing of the federal tax lien in the office of the register or recorder of deeds in the county in which the land is located. Examination of a title coming through such a sale must include verification that the following steps were carried out.

The Special Procedures staff of the District Director's office handles the levy and sale proceedings. In connection therewith, they usually prepare and in some cases file for record after the sale of the following documents:

Notice of Seizure
Notice of Sale
Record of Seizure and Sale of Real Estate
Seized Properties Sale Report
District Director's Deed

Examination of these documents will be helpful in establishing compliance with some but probably not all of the statutory requirements discussed herein. Often Form 21, which is a synopsis of the procedures followed, is the only document available from the government's file.

Levy

Section 6331(a) provides that if any person liable to pay any tax neglects or refuses to pay the same within 10 days after notice and demand, it shall be lawful for the Secretary to collect such tax and expenses of levy by levy upon all property and rights to property belonging to such person or on which there is a lien provided by law for the payment of such tax. No levy may be had upon property exempt under Section 6334, but that section exempts only certain categories of personal property. No other exemptions, including those established under state law, are available.

The District Director's deed may contain a recital that notice and demand for payment of the tax liability was made on a certain date and not paid within 10 days thereafter. If this recital is consistent with the other information available to you, you may rely upon it as establishing compliance with the corresponding requirement of Section 6331(a). If the Notice of Seizure correctly describes the taxpayer, the tax due, and the property seized, it probably meets the requirement of a "levy" under Section 6331(a).

Notice of Seizure

Section 6335 deals with the procedure for sale of seized property. Section 6335(a) provides for notice of seizure, and requires that notice be given to the owner as soon as practicable after seizure or left at his usual place of abode or business within the district. If the owner cannot be readily located or has no dwelling place or place of business within the district, the notice may be mailed to his last known address. The notice shall specify the sum demanded and a description of the real property seized. Problems in proving compliance with Section 6335(a) will probably be common. Since the statute requires that notice be "given" the taxpayer, it must be established that the taxpayer received the notice. If the Record of Seizure and Sale of Real Estate or the Seized Properties Sale Report states that the notice was personally served upon the taxpayer by the agent, it is probably sufficient. In many cases, however, these documents will reflect that notice was mailed to the taxpayer, and there will be no evidence concerning receipt. Mailing without evidence of receipt is permissible only as an alternate means of service where the owner cannot be readily located or has no dwelling place or place of business within the district, and, as such, carries the risks associated with titles coming through a judgment with service based on publication. If a good faith effort to locate the taxpayer was not made before placing the notice in the mail, the taxpayer may have been deprived of his property without due process of law.

Notice of Sale

Section 6335(b) deals with notice of sale and says that as soon as practicable after seizure, the Secretary or his delegate shall give notice to the owner in the manner prescribed in subsection (a), and shall cause publication in a newspaper published or generally circulated in the county where the seizure is made. Obviously, the same problems respecting service of the notice of seizure will be encountered here. There should also be a publisher's affidavit attached to either the Record of Seizure and Sale or the Sale Report, although this seems to be commonly omitted. The Notice of Sale must describe the property being sold, and the time, place, manner and conditions of sale.

Time and Place of Sale

Section 6335(d) specifies that the time of sale shall not be less than 10 nor more than 40 days from the time of giving public notice under subsection (b). The sale must be within the county in which the property is seized, except by special order of the Secretary. The circumstances under which the Secretary will approve a sale in a county other than the one in which the land is located are not known. It is the Company's position in such cases that no such sale may be insured without the approval of your Company underwriting advisor.

Manner of Sale

Section 6335(e) establishes the manner and conditions of sale. The Secretary must determine a minimum price for which the property shall be sold, and whether it would be in the best interests of the United States to take the property at that price. If no offers are received for at least the minimum price, the property may be declared purchased at such price for the United States. If an offer of at least the minimum price is received, the property must be sold to the highest bidder. Section 6335(e) goes on to require that the sale shall not be conducted in any manner other than public auction or public sale under sealed bids.

Redemption

Section 6338 states that a certificate of sale shall be given to the purchaser, and if the property is not redeemed within the 180-day period provided in Section 6337, the Secretary shall give a deed to the purchaser upon surrender of the certificate.

Underwriting Requirements

The insurance of any title coming through foreclosure of a non-consensual lien involves a greater-than-normal risk and, in many cases, an unacceptable risk. The Company has determined that it will insure titles coming through levy and sale under a general federal tax lien under the following conditions:

1. The proposed Insured must be a bona fide purchaser or mortgagee, and not the original purchaser from the IRS.

2. The sale under levy must have occurred at least one year ago.

3. The purchaser under levy or those claiming under him must be in possession of the land.

4. The holders of all interests extinguished by the sale under levy must have actually received notice of sale.

5. The documents pertaining to the levy must reflect that all procedural requirements have been satisfied, and that the levy and sale proceedings were conducted in accordance with law. These documents must be filed for record.

6. Evidence should be obtained that no redemption in fact took place.

Federal Revenue Liens

Federal Estate Tax

YOU MUST MAKE AN EXCEPTION OF THE LIEN OF THE FEDERAL ESTATE TAX AS TO ANY ESTATE OR INTEREST IN LAND WHICH IS INCLUDED WITHIN THE "GROSS ESTATE" OF A DECEDENT UNLESS YOU HAVE DETERMINED THAT (A) THERE IS NO SUCH TAX DUE, (B) THE TAX HAS BEEN DETERMINED AND PAID, (C) ITS ENFORCEMENT HAS BEEN BARRED BY LAPSE OF TIME, (D) THE ESTATES OR INTERESTS IN QUESTION HAVE BECOME FULLY VESTED IN A SURVIVING JOINT TENANT(S) OR TENANT BY THE ENTIRETY BY REASON OF THE DEATH OF THE DECEDENT, OR (E) THE TAX LIEN HAS BEEN TRANSFERRED TO OTHER PROPERTY BY CONVEYANCE OR MORTGAGE TO A BONA FIDE PURCHASER OR MORTGAGEE.

Gross Estate

An estate tax lien attaches to the gross estate at the decedent's death and continues for ten years thereafter unless the tax is paid sooner. For tax lien purposes, the gross estate can include two types of property. First, the so-called "IRS Regulation Section 2033" (26 U.S.C. 2033) property is property that was vested in the decedent at the time of death and passed to heirs or devisees.

With respect to Section 2033 (probate) properties, the lien is not divested unless the entire proceeds from any specific property are used to pay charges against the estate and administrative expenses allowed by the court or for payment of the federal estate taxes. To be safe on Section 2033 properties, obtaining a certificate of discharge or proof of payment is the best approach.

The second type includes properties listed in Sections 2034 through 2042. These are properties in which a beneficiary has acquired an interest during the decedent's life, although the property is part of the estate for federal tax purposes. The properties include transfers in contemplation of death, jointly held properties with rights of survivorship and inter vivos revocable transfers or those intended to take effect in possession or enjoyment after death.

With respect to the non-2033 properties, the property will be divested of the lien if the property has been conveyed to a protected bona fide purchaser or holder of a security interest. See 26 U.S.C. 6324.

Determination And Payment Of The Tax

The United States is entitled to be paid a tax from the assets of a deceased person, the right to such tax with a lien for the same attaching to the assets immediately upon the death of the decedent. The personal representative of the decedent is required to file with the United States a tax return within a limited period (nine months unless extended) and to pay any tax shown due thereon. The United States is not required to file any notice of its right to the tax, of the fact that the personal representative has not filed the return within the required time or that, a return having been filed, the tax shown due thereon has not been paid. The lien continues without any public notice for a period of 10 years from the date of the decedent's death.

Unless, consequently, 10 years have elapsed since the date of death with no notice of lien filed in the Recorder's Office for the recording area where the land is located, you must determine whether (a) a return has been filed, the return has been audited, and the tax has been paid or (b) if no return has been filed whether the assets of the estate are sufficient to subject them to the payment of an estate tax.

An estate tax return for decedents dying in 1987 and subsequent years must be filed if the gross estate is in excess of the amounts set forth below: (Note, however, that the amounts set forth in the following chart must be reduced by the sum of any adjusted taxable gifts made by the decedent plus any specific exemption allowed under prior law for gifts made by the decedent)

Year of Death	Amount of Exclusion (Size of Estate)
1987 through 1997	$600,000
1998	$625,000
1999	$650,000
2000 or 2001	$675,000
2002 or 2003	$1,000,000
2004 or 2005	$1,500,000
2006, 2007 or 2008	$2,000,000
2009	$3,000,000
2010	$5,000,000*
2011	5,000,000
2012	5,120,000

For the first 11 months of 2010 the Federal Estate Tax had been effectively repealed by Congress failing to address the issue. Congress then passed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act (the Tax Relief Act of 2010) on December 17, 2010. The new law amends the Estate, Gift and GST (Generation Skipping Trusts) provisions of the Tax Code and it has a sunset provision that requires it to end in 2013.* The new exemption limits are RETROACTIVE for all estates opened in 2010, in the sense that they have established a tax liability for deaths in 2010 that did not have any Federal Estate Tax liability prior to passing this act. This means that an estate could have been opened and closed in 2010 and, if large enough, it may have to be reopened to address the tax liability issues. It does allow 2010 estates to opt out of Estate Tax liability and chose to follow the Carry-over basis with possible capital gains effect on the tax liability of the estate or heirs. YOU MUST ANALYZE ANY CHAIN OF TITLE WHICH INCLUDES A DEATH IN 2010 WITH RESPECT TO THIS NEW LIABILITY and discuss the impact with your Company underwriting advisor.

You are not entitled to assume that the estate is not sufficient in value to be subject to an estate tax simply because the inventory or other information filed in the administration proceedings on the estate reflects a lesser value than that described in the above table. Assets which are not included in administration proceedings, such as the proceeds of life insurance policies payable on the death of the decedent to persons other than his estate, and the value of property held by the decedent as a joint tenant or as a tenant by the entirety, must be included in determining the amount of assets for estate tax purposes.

You must exercise considerable judgment, therefore, in accepting proof that the estate is not of sufficient size to be subject to federal estate tax. If your investigation shows, nevertheless, that the total value of all assets subject to estate tax is considerably less than the minimums set forth above and consequently that there is little likelihood that a tax is due, you may rely upon this investigation and issue a title policy without an exception as to the possible lien of a federal estate tax.

Do not rely upon a court directed sale of the estate or interest for payment of debts, costs of administration and so forth, to divest the lien of the federal estate tax unless all of the sale proceeds are used to pay the claims of creditors and cost of administration. These have a priority over the estate tax. But if the proceeds of the sale are used for additional purposes, such as for distribution to heirs or devisees at the termination of administration, the estate tax lien may have been divested only as to the amount used to pay creditors and administration costs.

In large estates where a federal estate tax will be due but where the return has not yet been filed, it is possible to procure a release from the Commissioner of Internal Revenue (Commissioner's Form #792) as to the estate or interest which is to be conveyed. If such a release is furnished, the title policy can be issued without exception as to the lien of the federal estate tax.

Lapse Of Time

The lien of a federal estate tax attaches as of the date of death and continues for a period of ten years, but see below. No notice is required for the lien arising in this manner.

It is also possible for a lien to arise by reason of the assessment of the tax, in which event the lien continues for the same period of time as any other general tax lien. It does not affect, however, the rights of a purchaser or the holder of a security interest unless a notice of the tax lien is filed for record, as is required in the case of any general tax lien.

The lien may exist for extended periods of time if it falls within the category of a "special" tax lien which arises by reason of (1) an agreement made by the owners of the estate or interest to pay the tax in installments, (2) if the estate or interest is in a closely held business or is an interest in a farm or, (3) to pay the tax when the use of the estate or interest changes, if such change in use causes an increase in the value of the estate or interest. Notice of the special lien, however, must be given to the purchasers and holders of security interests by filing the agreement of record. The lien continues, then, for such time as a right exists to enforce the agreement. It need not be refiled to keep the lien in effect for that time. When you accept proof that a federal estate tax has been paid, require that the return be shown to you so that you can be sure there has been no deferment of tax.

Transfer Of Lien To Other Property

If the estate or interest became fully vested in a surviving joint tenant(s) or surviving tenant by the entirety by reason of the decedent's death, the lien of the estate tax attaches to such estate or interest but is transferred to other property of the transferor if the surviving joint tenant(s) or tenant by the entirety transfers the estate or interest to a bona fide purchaser or creates a security interest in a bona fide holder of a security interest.

(a) It is not necessary that the purchaser or holder of the security interest take without knowledge of the possibility of the federal estate tax lien, but he must be a purchaser for value in an arms-length transaction.

(b) The transfer, however, is not effective to transfer the lien to other property if a notice of tax lien, above, has been filed for record and indexed prior to the transfer.

Federal Revenue Liens

Federal Gift Tax

DO NOT INSURE A TRANSFEREE, WHO HAS ACQUIRED OWNERSHIP OF AN ESTATE OR INTEREST IN LAND BY GIFT, WITHOUT AN EXCEPTION AS TO A POSSIBLE LIEN FOR FEDERAL GIFT TAX. YOU MAY INSURE THE OWNERSHIP OF A PURCHASER FROM ANY SUCH TRANSFEREE OR ONE WHO ACQUIRES A MORTGAGE FROM ANY SUCH TRANSFEREE PROVIDED (A) THE PURCHASER OR MORTGAGEE HAS PAID TO THE TRANSFEREE AN ADEQUATE AND FULL CONSIDERATION IN MONEY OR MONEY'S WORTH AND (B) NO NOTICE OF ANY TAX LIEN HAS BEEN FILED.

Nature Of The Tax Lien

The United States imposes a tax on gifts which exceed a specified amount, with a lien attaching to the estate or interest transferred on the date of the gift, which lien continues for a period of ten years. No action by the United States is required to make this lien effective against the estate or interest in the hands of the transferee or those claiming by, through or under the transferee except as to a purchaser or holder of a security interest for value paid (an adequate or full consideration in money or money's worth). In this latter instance, the lien is transferred to the money or property given by the purchaser or holder of the security interest.

A notice of tax lien may be filed for record if a tax has been assessed and, if so, the notice is effective for the same period, or extended periods, in the event of refilings, as any general tax lien.

Procedures For Showing Lien

If a notice of tax lien is filed, you must require that the lien be discharged before issuing any title policy, even to a purchaser or holder of a security interest for value, or in the alternative, make an exception of the lien in Schedule B of the policy in substantially the following language:

> *Notice of tax lien filed for record on ___________ as Document No. ___________ against (name of donee) in the amount of $___________.*

If no notice or tax lien is filed, but if it appears from the instruments of record or other information known to you that the insured acquired ownership of the estate or interest by gift, make the following Schedule B exception:

> *Lien in favor of the United States for gift tax, if any, arising from a gift of the estate or interest described in Schedule A to (here insert name of donee).*

You should make an appropriate exception as to the possible lien in the event the insured is a mortgagee or assignee who acquired either the mortgage or the assignment of the mortgage by gift.

Note that the exception need not appear if the insured has paid an adequate and full consideration in money or money's worth for a transfer from the transferor who acquired the estate, interest or security interest by gift.

FEDERAL MORTGAGE FORECLOSURE ACTS

Federal Single Family Mortgage Foreclosure Act

FORECLOSURES CONDUCTED PURSUANT TO THE PROVISIONS OF THE SINGLE FAMILY MORTGAGE FORECLOSURE ACT REQUIRE SPECIAL UNDERWRITING INSTRUCTIONS.

In 1994, Congress passed the Single Family Mortgage Foreclosure Act, 12 U.S.C. 3751-3768, (the "Act") which authorizes the Secretary of Housing and Urban Development (HUD), as a matter of Federal law, to exercise a statutory nonjudicial power of sale with respect to any defaulted single family mortgage held by the Secretary under Title I or II of the National Housing Act or under Section 312 of the Housing Act of 1964.

The Federal regulations under the Act are set forth in 24 Code of Federal Regulations Part 27 sections 27.100 to 27.123.

Foreclosure Commissioner
The Secretary may designate a person or persons to serve as a foreclosure commissioner for the purpose of foreclosing single family mortgages; as such, a foreclosure commissioner has a nonjudicial power of sale as provided under the Act. The foreclosure commissioner, if a natural person must be a resident of the state in which the security property is located and, if not a natural person, the foreclosure commissioner must be duly authorized to transact business under laws of the state in which the security property is located. The Secretary of HUD delegated to the General Counsel of HUD and the General Counsel has re-delegated to the Field Assistant General Counsel the authority to appoint foreclosure commissioners and fix compensation.

Prerequisites Of Foreclosure

The Secretary may commence foreclosure of a single family mortgage under the Act upon the breach of a covenant or condition in the mortgage agreement. No foreclosure under the Act may be commenced unless any previously pending judicial or nonjudicial proceeding that has been separately instituted by the Secretary to foreclose the mortgage in a manner other than authorized in the Act has been withdrawn, dismissed or otherwise terminated.

Commencement Of Foreclosure

If the Secretary determines that the prerequisites to foreclosure are satisfied, the Secretary may direct the foreclosure commissioner to commence foreclosure of the mortgage.

Notice Of Default And Foreclosure Sale

The commissioner commences the foreclosure by serving a Notice of Default and Foreclosure Sale. The Notice sets forth the name, address and telephone number of the foreclosure commissioner and the date on which the Notice was issued, along with the following information:

1. The current mortgagee (that is, the Secretary), the original mortgagee (if other than the Secretary), and the original mortgagor.

2. The street address or a description of the location of the security property a description of the sufficient to identify the property to be sold.

. The date of the mortgage, the date the mortgage was recorded, the office in which the mortgage is recorded, and the liber and folio numbers or other appropriate description of the location of recordation of the mortgage.

4. Identification of the failure to make payment, including the entire amount delinquent as of a date specified, a statement generally describing the other costs that must be paid if the mortgage is to be reinstated, the due date of the earliest principal installment payment remaining wholly unpaid as of the date on which the Notice is issued, or a description of any other default or defaults upon which foreclosure is based, and the acceleration of the secured indebtedness.

5. The date, time, and location of the foreclosure sale.

6. A statement that the foreclosure is being conducted in accordance with the Act.

7. A description of the types of costs, if any, to be paid by the purchaser upon transfer of title.

8. The bidding and payment requirements for the foreclosure sale, including the amount and method of deposit to be required at the foreclosure sale, and the time and method of payment of the balance of the foreclosure purchase price. The Notice must state that all deposits and the balance of the purchase price must be paid by certified or cashier's check. The Notice must also state that no deposit will be required of the Secretary when the Secretary bids at the foreclosure sale.

9. Any other appropriate terms of sale of information as the Secretary may determine.

Service Of Notice Of Default And Foreclosure Sale

The foreclosure commissioner will serve the Notice of Default and Foreclosure Sale upon the following persons and in the following manner:

1. Filing the notice.

   The Notice of Default and Foreclosure Sale must be filed not less than 21 days before the date of the foreclosure sale in the manner authorized for filing a notice of an action concerning real property according to the law of the State in which the security property is located, or if none, in the manner authorized by Section 3201 of title 28, United States Code.

2. Notice by mail.

   A. The Notice must be sent by certified or registered mail, postage prepaid, return receipt requested, to the following (except that multiple mailings are not required to be sent to any party with multiple capacities, e.g., an original mortgagor who is the security property owner and lives in one of the units):

(1) The current security property owner of record, as the record existed 45 days before the date originally set for the foreclosure sale, whether or not the notice describes a sale adjourned as provided in the Act. The Notice must be mailed not less than 21 days before the date of the foreclosure sale to the current owner at the last address known to the Secretary or the foreclosure commissioner or, if none, to the address of the security property, or, at the discretion of the foreclosure commissioner, to any other address believed to be that of the current owner.

(2) The original mortgagor and all subsequent mortgagors of record or other persons who appear on the basis of the record to be liable for part or all of the mortgage debt, as the record existed 45 days before the date originally set for the foreclosure sale, whether or not the Notice describes a sale adjourned as provided in the Act, except that the Notice need not be mailed to any mortgagors who have been released from all obligations under the mortgage. The Notice must be mailed not less than 21 days before the date of the foreclosure sale to the last known address of the mortgagors or, if none, to the address of the security property, or, at the discretion of the foreclosure commissioner, to any other address believed to be that of such mortgagors.

(3) All dwelling units in the security property, whether or not the Notice describes a sale adjourned as provided in this part. The Notice shall be mailed not less than 21 days before the date of the foreclosure sale. If the names of the occupants of the security property are not known to the Secretary, or if the security property has more than one dwelling, the Notice must be posted at the security property not less than 21 days before the foreclosure sale.

(4) All persons holding liens of record upon the security property, as the record existed 45 days before the date originally set for the foreclosure sale, whether or not the notice describes a sale adjourned as provided in the Act. The Notice must be mailed not less than 21 days before the date of the foreclosure sale to each such lienholder's address of record, or, at the discretion of the foreclosure commissioner, to any other address believed to be that of such lienholder.

B. Notice by mail is deemed duly given upon mailing, whether or not received by the addressee and whether or not a return receipt is received or the notice is returned. The date of the receipt for the postage paid for the mailing may serve as proof of the date of mailing of the notice.

3. Publication.

A. A copy of the Notice of Default and Foreclosure Sale must be published once a week during three successive calendar weeks before the date of the foreclosure sale. Such publication must be in a newspaper or newspapers having general circulation in the county or counties in which the security property being sold is located. A legal newspaper that is accepted as a newspaper of legal record in the county or counties in which the security property being sold is located is a newspaper having general circulation for the purposes of this paragraph.

B. If there is no newspaper of general circulation published at least weekly in the county or counties in which the security property being sold is located, copies of the Notice of Default and Foreclosure Sale must be posted, not less than 21 days before the date of the foreclosure sale, at the courthouse of any county or counties in which the security property is located and at the place where the sale is to be held.

Conduct Of Sale
The foreclosure sale will be held at public auction between the hours of 9 o'clock and 4 o'clock local time and scheduled for a place where foreclosure real estate auctions are customarily held in the county where the land is located or at a courthouse therein, or at or on the property to be sold. Neither the foreclosure commissioner not any relative, related business entity or employee of the foreclosure commissioner shall be permitted to bid at the sale.

Transfer Of Title And Possession
The foreclosure commissioner will issue a deed without warranties or covenants to the purchaser upon receipt of the entire purchase price in accordance with the terms of the sale as provided in the Notice of Default and Foreclosure Sale.

Record Of Foreclosure And Sale
The foreclosure commissioner must include in the recitals of the deed to the purchaser, or in an affidavit or addendum to the deed, the following items:

1. The date, time, and place of the foreclosure sale.

2. A statement that the foreclosed mortgage was held by the Secretary.

3. The date of the foreclosed mortgage, the date of the recording of the mortgage that was foreclosed, the office in which the mortgage was recorded, and the liber and folio numbers or other appropriate description of the recordation of the mortgage.

4. The details of the service of the Notice of Default and Foreclosure Sale, including the names and addresses of the persons to whom the Notice was mailed and the date on which the Notice was mailed, the name of the newspaper in which the Notice was published and the dates of publication, and the date on which service by posting, if required, was accomplished.

5. The date and place of filing the Notice of Default and Foreclosure Sale.

6. A statement that the foreclosure was conducted in accordance with the provisions of the Act and with the terms of the Notice of Default and Foreclosure Sale.

7. The name of the successful bidder and the amount of the successful bid.

The foreclosure commissioner may, in his or her discretion, make the recitations in the deed or in an affidavit or addendum to the deed, either of which is to be recorded with the deed as provided in the Act.

Requirements

Before agreeing to insure titles using the Act, you should conduct an investigation to determine if, in your jurisdiction, any actions have been brought, or are pending under either the multifamily or the single family foreclosure law challenging the foreclosure action on constitutional grounds. If such and act has been filed, you should contact you Company underwriting adviser before proceeding with the transaction.

1. Applicability of the Foreclosure Act

   Examine the mortgage to determine that it is a “single family mortgage” as defined in the Act. The term “single family mortgage” means a mortgage that covers property on which there is located a one-to-four family residence and is held by the Secretary pursuant to Title I or Title II of the National Housing Act 12 U.S.C. 1702 et seq., or 1707 et seq., or secures a loan obligated by the Secretary under Section 1452b of Title 42 as it existed before the repeal of that section by Section 12839 of Title 42.

2. Default

   (a) Check the notice of default and foreclosure sale to ascertain that the default recited therein was also a default under the mortgage. Ordinarily, there will be a monetary default, and this should present no problem.

   (b) Verify that a notice of cancellation of the foreclosure has not been filed.

3. Designation of Foreclosure Commissioner

   Unless you have information to the contrary, rely on the recitals in the deed, or in the affidavit or addendum to the deed, that the foreclosure commissioner was duly designated by the Field Assistant General Counsel of the

Department of HUD and that the foreclosure commissioner was qualified under the Act.

4. Dismissal of Prior Foreclosure

Unless you have information to the contrary, rely on the recitals in the deed, or in the affidavit or addendum to the deed, that any prior foreclosure proceedings, either judicial or nonjudicial, have been dismissed or terminated prior to service of the notice of default and foreclosure sale.

5. Notice of Foreclosure Sale

Examine the Notice of Default and Foreclosure Sale to ascertain that it sets forth the items required by the Foreclosure Act.

6. Service of Notice and Designation

(a) Ascertain that the Notice of Default and Foreclosure Sale and the designation of foreclosure commissioner were served by registered or certified mail, return receipt requested, upon the proper parties and within the applicable time periods. Please note that the regulations require notice to "all subsequent mortgagors of record" and to all lien holders, including senior lien holders. Senior lien holders cannot be foreclosed. However, it is HUD's position that these requirements are statutory requirements. (See Final Rule, Federal Register, Vol. 60, No. 220 page 57487.) We are requiring that the Notice and designation be served at the address stated in the mortgage, regardless of any other address where service may also be made. Raise an exception as to the rights of specific parties not properly served.

(b) Ascertain that, in addition to service by mail as noted above, the Notice of Default and Foreclosure Sale has been published and posted in the manner required by the Act.

(c) The Act fixes a date 45 days prior to the date originally set for the foreclosure sale as the date for determining the parties entitled to notice. This date may not satisfy due process requirements.

Therefore, raise an exception as to the rights of parties whose interest arose of record during that period and who were not served. It is HUD's intention that liens arising in the gap period between the 45 day deadline for determining who should receive notice and the 21 day deadline for filing the Notice would remain "and would have to be cleared." (See Final Rule, Federal Register, Vol. 60, No. 220, pages 57485 - 57486.)

(d) The Act does not preempt the Federal Tax Lien Act. Therefore, continue to show junior federal tax liens unless and until: (a) the United States was given timely notice under the Federal Tax Lien Act (not less than 25 days prior to sale), and (b) no redemption was made within the redemption period (120 days from the date of sale or the period allowable for redemption under local law, whichever is longer). See 26 U.S.C. 7425 (c) and (d).

7. Conduct of Sale

Unless you have information to the contrary, rely on the recitals in the deed, or in the affidavit or addendum to the deed, that the statutory provisions regarding the conduct of sale have been followed. The statute provides that the deed and affidavit executed by the foreclosure commissioner shall be accepted for recordation upon the payment of the usual recording fees "without regard to the compliance of those instruments with any other local filing requirements." Notwithstanding this provision, we will require proper execution and acknowledgment under state laws.

8. Foreclosure Commissioner's Deed

Determine whether the foreclosure commissioner's deed was properly executed, acknowledged and recorded, and whether the recitals therein, or in the affidavit or addendum to the deed, set forth the matters required by the Foreclosure Act.

9. Matters Which Survive The Foreclosure Sale

(a) The foreclosure sale is subject to all liens and encumbrances prior to the mortgage foreclosed thereby. The Act does provide for use of sale proceeds to pay valid tax liens or assessments prior to the mortgage and to pay other prior liens required to be paid by the terms of the sale. Ordinary underwriting rules govern the discharge of such prior taxes, assessments and liens.

(b) Any matter described in the Notice of Default and Foreclosure Sale, which are to survive the foreclosure sale should be shown as an exception to title. In particular, look out for provisions which require that the purchaser continue to operate the property in accordance with any federal housing program.

10. Evidence of Possession in Grantee

(a) Require evidence that the grantee in the foreclosure commissioner's deed is in possession of the property. For property other than a single family residence possession can be evidenced by management of the building and collection of rents, either personally or through an agent or employee.

(b) If the grantee is not in possession, raise an exception as to the rights of the specifically named party in possession, other than tenants of residential units.

11. Attacks on Title of Purchaser

(a) Raise an exception for any judicial proceeding seeking to modify or set aside the foreclosure sale and or the title coming through such sale.

(b) Do not insure title for an amount in excess of the sale price until title has been conveyed to a bona fide purchaser.

12. Submission to Company Underwriting Advisor

Requests to rely on a record which is substantially incomplete, to waive defects in such foreclosures, or to waive the rights of parties not properly notified or who remain in possession should be submitted to your Company underwriting advisor.

FEDERAL MORTGAGE FORECLOSURE ACTS

Federal Multifamily Foreclosure Act

FORECLOSURES CONDUCTED PURSUANT TO THE PROVISIONS OF THE MULTIFAMILY MORTGAGE FORECLOSURE ACT REQUIRE SPECIAL UNDERWRITING INSTRUCTIONS.

The Multifamily Mortgage Foreclosure Act (12 U.S.C.A. § 3701 to 3717) has, since 1982, allowed mortgages on qualifying property (more than four residential units) held by HUD to be foreclosed non-judicially under statutory procedures which may conflict with state laws concerning redemption rights and other matters. Federal law pre-empts where the foreclosure complies with the provisions of the Act. The Company’s long-standing underwriting directives, which reflect the risk that mortgagors will seek to assert that such procedures are invalid, include declining to insure title for an amount in excess of the foreclosure sale price until the title has been conveyed to a bona fide purchaser.

Please refer to the <u>Section Federal Mortgage Foreclosure Acts 1</u> of this manual which discusses a comparable federal statute, the Federal Single Family Mortgage Foreclosure Act (from 1994). That Act is likewise a pre-emptive statute and one which provides for non-judicial foreclosure and other potential conflicts with state law rights with respect to properties with one-to-four residential units. Please review the requirements shown in that section and follow the same analysis for the insurance of property that has utilized the Multifamily foreclosure process. Two additional requirements for the Multifamily process are

- the notice must be posted on premises, and
- the date of the foreclosure sale shall not be prior to 30 days after either earliest unpaid installment or the earliest occurrence of a non-monetary default.

It should be noted that these acts do <u>not</u> pre-empt the Federal Tax Lien Act and junior federal tax liens should continue to be shown after foreclosure sale, unless the United States was given timely notice (not less than 25 days prior to sale) and no redemption was made within the redemption period (120 days from date of sale or period allowable under local law, whichever is longer).

We should **not** insure for an amount in excess of the sale price at the foreclosure until the property has been conveyed to a bona fide purchaser.

Fixtures and Crops

THE DESCRIPTION OF THE LAND IN SCHEDULE A INCLUDES (A) FIXTURES, I.E. CHATTELS OR ITEMS OF PERSONAL PROPERTY WHICH HAVE BEEN ATTACHED TO THE LAND SO AS TO HAVE BECOME A PART OF IT AND (B) GROWING CROPS.

ALTHOUGH YOU SHOULD NOT SPECIFY IN THE POLICY WHETHER ANY PARTICULAR ITEM HAS BECOME A FIXTURE OR IS STILL A CHATTEL, OR WHETHER THERE ARE GROWING CROPS ON THE LAND, YOU MUST SEARCH FOR, AND SHOW, CLAIMS OF OWNERSHIP, LIENS AND ENCUMBRANCES WHICH AFFECT FIXTURES AND GROWING CROPS AND WHICH MAY NOT AFFECT THE REMAINDER OF THE LAND.

Fixtures

Do not itemize or otherwise specify in Schedule A parts of the land which once were chattels but have become fixtures and, as such, a part of the Land without the approval of your Company underwriting advisor.

a. The ALTA policies define Land as “The land described in Schedule A, and affixed improvements that by law constitute real property.” Therefore, if a chattel has become a fixture it is included within the coverage of the policy as a part of the land, but if it has not become a fixture, it is not included.

b. The rules, which determine a chattel has become a fixture, are determined by the law of the state where the land is located; the application of these rules may require judicial determination of questions of fact.

c. Requests that the policy affirmatively state that particular items (such as heavy machinery in a factory, built-in stoves, refrigerators, etc. in an apartment building) are fixtures and are included within the policy coverage must be referred to your Company underwriting advisor.

You must exclude from the policy coverage, nevertheless, any particular fixture, the ownership of which is different than the ownership of the remainder of the land, and make a Schedule B exception of any claims of ownership, liens and encumbrances which affected a particular chattel before it became a fixture and which survived the change in status.

a. The ownership of a building sometimes is separated from the ownership of the remainder of the land; if the building is not physically severed, it may still constitute land.

i. If insuring only the Fee interest in the land, exclude the building from the description of the land in Schedule A and raise an appropriate exception for possible access rights, support rights, etc. of the building owner.

ii. The ownership of the severed building can only be insured in conjunction with the insuring of associated leasehold interests.

b. A claim of ownership, lien or encumbrance can attach to a chattel before it becomes a fixture and, if notice of the change is properly made a part of the public records, will continue to affect the item after it has become a fixture.

i. This frequently occurs with built-in stoves, refrigerators, dishwashers, siding, flooring, furnaces, and similar chattels which are installed in residences and apartments. In addition, any indication of the existence of a mobile home (which can be brought in from another jurisdiction and installed on a foundation on the site) should be investigated and appropriate exceptions raised. Please review the **Endorsement Manual Section 7** for further discussion of these issues.

ii. The search procedure which must be made to discover these matters and the form of the necessary Schedule B exceptions to be used vary from state to state, and must be verified with the appropriate Company underwriting advisor for the area in which the land is located.

Growing Crops

You should except any reservation of a growing crop from the description of the land in Schedule A. This reservation sometimes appears in a deed when the seller retains the right to harvest a growing crop; the following is an example of a proper form of description with crop exception language:

> *The Southwest ¼ of Section 15, Township __, Range__ in ____ County, Kansas, except the wheat presently growing on the land.*

Do **not** remove the General Exception as to the rights of parties in possession if there are growing crops on the land without determining whether such crops have been planted by a tenant or licensee who has the right to enter and remove them.

Make the additional searches required for growing crops (as required in that state) if the land is agricultural or vacant land; if it is not customary in your area to report growing crop mortgages, then make the following Schedule B exception:

> *Liens, if any, on the growing crops on the land.*

Foreclosure – Foreclosure And Purchase Of Reo Property

INSURING THE SALE OF REAL ESTATE AT THE FORECLOSURE SALE OR OWNED BY A LENDER (REO) RAISES CERTAIN UNDERWRITING ISSUES.

It is the intention of the Company not to assume liability for deficiencies in the foreclosure process that, as recent history shows, may not be apparent upon examination of the available records. We have particular concerns about insuring a lender, or its related company, that purchases at its own foreclosure, and we are not willing to issue insurance to that entity.

Insurance of other third party purchasers at the sheriff's or trustee's sale **must** be approved by your Company underwriting advisor, usually the state counsel(s) for the state in which the Land is located. We have particular concerns about insuring transactions arising out of, or subsequent to, non-judicial sales by any trustee not expressly authorized by the pertinent state code to conduct a trustee's sale.

ALL STATE SPECIFIC GUIDELINES AND ANY UPDATES AND AMENDMENTS PREVIOUSLY DISTRIBUTED MUST BE COMPLIED WITH.

The FNF Family of Companies will continue to insure *subsequent* resale or mortgage transactions where the grantor or mortgagor was a purchaser of REO property, as long as at the time of the present transaction

- there are no known or pending claims against the property or a prior policy,
- current state law does not allow an attack on the title as insured, and
- the Land is insured by an owner's policy issued by the Company or issued by an acceptable non-family insurer. Any significant increase in liability over the existing owner's policy must be approved by your Company underwriting advisor.

FORECLOSURE – "CONSTRUCTIVE REDEMPTION"

BE MINDFUL WHEN A BORROWER ASSUMES AN OWNERSHIP POSITION AFTER A FORECLOSURE.

Whenever a previously foreclosed borrower comes back into title in any capacity, the title may once again be subject to any matters that had been successfully foreclosed. After a properly conducted foreclosure which results in the apparent extinguishment in law of inferior liens or other interests, the borrower resumes an ownership position by deed or by acquisition of a constituent interest in the title-holding entity. This may happen relatively quickly, or after a period of time. The borrower may do so in their own name, or using a representative entity. The problem is that a court of equity may view this later return of the borrower to an ownership interest as being tantamount to *redemption of the first lien*. Consequently, the court of equity may reinstate all other liens and interests to their former status. While our current practice is to show all judgments and liens against the buyer that would attach (or reattach) to the property when the former owner reacquires in its own name, this may not be as readily apparent when the previous borrower is a partner, member or sole shareholder of the new buyer.

The risk is not eliminated by the borrower re-acquiring a lesser interest than the one they had prior to foreclosure. The risk is not eliminated by the borrower attempting to hide their identity by using an alter ego entity to hold the interest.

Underwriters should not view this issue as safely covered by Exclusion 3 to the policies, if we are aware of facts which indicate the above scenario. For one thing, the borrower may obtain an Insured Mortgage from a new lender who has no knowledge of the prior situation. Or the borrower may have innocent co-venturers in the new ownership entity. If we know that the foreclosed borrower or an affiliated entity is re-acquiring an interest, no matter the period of time since the foreclosure, it is appropriate to raise an exception for the possibility of an assertion in a court of equity that a "redemption" has occurred. It will be necessary to re-raise as exceptions to title those liens previously treatable as having been extinguished by the foreclosure. Clearance of those items as exceptions is extra-hazardous and should be referred to your Company underwriting advisor.

Forfeitures

ANY APPLICATION TO INSURE THE TITLE TO LAND WHICH HAS BEEN THE SUBJECT OF FORFEITURE TO A FEDERAL, STATE OR LOCAL UNIT OF GOVERNMENT MUST BE REVIEWED BY YOUR COMPANY UNDERWRITING ADVISOR.

Generally

Forfeiture is a legal concept wherein the government may confiscate ownership of a piece of property as a penalty for the commission of a crime. When applied to real property, forfeiture laws create some constitutional issues unique to that kind of property.

There are two types of forfeiture available to the government: civil and criminal. The latter is imposed on the individual as part of punishment following conviction. Civil forfeiture, much more often utilized nowadays, is intended to confiscate property *used or acquired in violation of the law.* The law describes two kinds of situations where property may be forfeited. One is where it is alleged that the property was acquired with the proceeds of an illegal activity. The most common recent activity in recent years is the manufacture or sale of illegal substances, such as drugs. The second kind situation is where it is alleged that the illegal activity occurred on the property itself. This second situation may involve a trickier constitutional problem insofar as the property owner may not be the perpetrator of the crime. The illegal activity may in fact be the work of a tenant or even a trespasser. In all cases of civil forfeiture the legal action is *in rem*, that is, the action is not against the violator, but against the property itself.

Federal and state constitutions have provisions which require that before the government may deprive an individual of their property that due process must be followed. In general this concept involves proper notification of the charges (which in an *in rem* matter are against the property) and an opportunity for those with an interest in the property to be heard and respond.

After a government body has seized property, it will seek to sell the land to realize its benefit. In many instances, the law enforcement unit can keep the proceeds of sale to fund its own operations, rather than applying them to the general government revenue coffers. This motivates the unit to provide title as clean and marketable as will generate the highest purchase price on the open market. The examination of titles coming through forfeiture can be quite complex and subject to exceptional risk. Frequently, parties in addition to the perpetrator have interests which will need to be dealt with in order to provide a clear title. Spouses and lenders are the most common categories of these interests. Statutes invariably allow such parties to assert and prove that they are "innocent" and therefore must be compensated for their interest. While in the past, forfeiting government officials sometimes chose to fight these assertions, in recent years they have come to realize that paying them off still allows for monetary realization of the perpetrator's equity interest. The discussion is this section is intended to generally apply to any unit of government seeking to forfeit property as a result of criminal activity. However, what follows is limited to civil forfeitures by the federal government. These constitute the overwhelming number of instances where title insurance is requested. For other units of government or other types of forfeiture, contact your Company Underwriting Advisor.

THE FOLLOWING IS FOR DISCUSSION PURPOSES ONLY. YOU ARE REMINDED TO FOLLOW THE CURRENT DETAILED GUIDELINES CONTAINED IN REGIONAL COUNSEL UNDERWRITING BULLETIN NO. 2010-RC-07 ISSUED BY THE OFFICE OF THE CHIEF UNDERWRITING COUNSEL AS AMENDED AND UPDATED.

Documentation

Most U.S. Marshals will execute Special Warranty Deeds (SWDs) to buyers at sales (typically auctions) which have been directed by Final Orders of Forfeitures (FOFs) entered in judicial proceedings for civil forfeiture. Insuring title based on these SWDs and FOFs requires a determination by the underwriter that the FOF is sufficient in the following respects:

1. The FOF must recite who was served. The FOF must reference every record holder of an interest. The FOF must **name** each holder, not merely say that "everyone was served."

2. The FOF must recite the manner in which every holder of a record interest (except that of the criminal perpetrator) is going to be dealt with (e.g. deed from spouse. The government must acknowledge that <u>liens and taxes</u> will be paid.

3. If a record mortgagee is stated in the FOF merely as having been notified-- with nothing about disposition of

that mortgagee's interest-- then the FOF is insufficient for insurance purposes and the only way to agree to insure the buyer against loss by reason of the mortgage is if the U.S. will sign a special assurance form. The form is included at the end of this section. It is to be noted that the SWD does not alone solve the situation where the mortgagee was named but the government will not pay them at closing. It is not the intention of the Company to ignore any possible rights of outstanding mortgagees or spouses, even if served and there is no response. We require the FOF to specify that that court determines they have no interest in the property.

4. If the FOF is sufficient as above, and the SWD says, substantially, that the U.S. specially warrants against any claim or action arising from the federal case, with recitation of the case number and court involved, we will not require any further documentation. Specifically, we rely on the FOF and SWD with respect to proof of notice, copies of pleadings, proof of publication, etc. The SWD from the US Marshal must contain language similar to: "specially warrants the title to the property hereby conveyed against any claim or action arising from the federal case styled ………"

5. If the FOF does not contain sufficient findings as to these issues, we will not rely upon it.

6. We cannot rely on the FOF and SWD to correct any title issues that arose in the chain of title <u>before</u> the perpetrator came into title. The government cannot acquire or transfer any better title than the perpetrator received. Any such matters should be shown as is customary in your jurisdiction.

Special Assurance

It has been our understanding for a good number of years that the U.S. will no longer seek to have us "underwrite" insurance over unreleased liens, but will pay lien holders at closing. The assurance form which follows implements their intention to save purchasers harmless from any assertions with respect to unreleased liens. The form has been agreed to and executed on a number of transactions after consultation with the Senior Underwriting Staff.

- Special Assurance Concerning Assertions of Valid Liens Against Property Clear Title to Which has been Warranted by the United States Marshal

Pursuant to its authority to warrant clear title to forfeited property, and further in recognition that a special fund has been established pursuant to 28 USC 524(c) and 28 CFR 9.7(b) for the compromise and payment of valid liens and mortgages against property that has been forfeited, and with the understanding that ___________________(“Title Insurer”) shall be entitled to rely on this assurance in connection with its issuance to Buyers (identified hereinafter) of a title insurance policy on the forfeited property (identified on Exhibit A), the United States Marshals Service hereby assures Title Insurer as follows:

1. *In the event of a final order by a court of competent jurisdiction which rules that the United States of America did not acquire through the forfeiture process valid legal title to the property free and clear of the mortgage or lien that is identified on Exhibit A as “lien in question”, and therefore was not able to convey clear title to the Buyers, the United States will (a) refund to the Buyers an amount equal to the purchase price paid by the Buyers for the forfeited property, or in the alternative, (b) comply with the warranty of title to the Buyers by clearing title of the lien in question to the satisfaction of the Title Insurer.*

2. *In the event of any assertion by the holder or purported holder of the lien against the forfeited property in question, the United States of America will, without delay, determine the validity of the asserted lien and will either (a) pay it off out of the assets of the Assets Forfeiture Fund, or (b) will seek and obtain such evidence of the termination and extinguishment of the lien as will comply with the warranty of clear title which was made to the Buyers, which evidence will be in the form of either (i) a final order by a court of competent jurisdiction quieting title to the forfeited property free and clear of the lien in question, or (ii) a recordable release of lien.*

3. *The United States holds the Title Insurer harmless from loss it may suffer by reason of any claim made by the Buyers for a matter which is encompassed by the warranty of title contained in the deed to the Buyers.*

The Buyers of the property are ___________________________________

Dated___ At ____

[Exhibit A will contain a legal description of the property and also a description of the lien in question]

Homeowners Equity Line Of Credit (Heloc) Loans

WHENEVER YOU PAY OFF A HELOC, STEPS MUST BE TAKEN TO ELIMINATE THE RISK THAT THE BORROWER WILL CONTINUE TO DRAW DOWN ON THE LOAN.

We are experiencing a large number of claims wherein we have "paid-off" a mortgage that collateralizes a Homeowners Equity Line of Credit ("HELOC"), only to find the borrower (the seller, or the party refinancing) continued to make draws on the line post-closing. You can expect pressure from the purchaser's attorney and mortgagee to accept these risks, but title insurance premiums are not adequate to compensate us for assuming them. We must not become the insurer of the seller's repaying its equity line. To avoid facing this situation there are a number of steps you should take when paying off a line of credit to eliminate the risk that the borrower will continue to withdraw funds after the lender submits its payoff statement:

1. Close the Equity loan account before the payoff is issued
If you are making a written request for a payoff letter on a revolving credit equity loans, include the sample "freeze" language (below) and have the borrower sign it. Send a **second letter** from the borrower(s) with the payoff check confirming that the account is closed and ordering the lender to satisfy the mortgage or deed of trust (the Credit line Authorization form).When you ask the borrower(s) to sign the letters, explain to them that:

- This loan is now closed;
- They cannot borrow against it;
- They must destroy any credit card or checks attached to the account;
- The lien of the mortgage or deed of trust does not move with them to their new home, if any.

2. Include the borrower(s) signed Credit Line Authorization form (attached) with the payoff check or fax to the lender if wiring the payoff funds;

3. Obtain an updated payoff figure no more than two days prior to payment in full.

Doing so will help protect us against late penalties, increased interest rates, new charges by the borrower, and annual fees or assessments that may have intervened after the date of the original payoff statement.

Additional general requirements
In addition, you should comply with these general requirements, depending on your jurisdiction, to reduce our liability in this area:

- Examine each unreleased mortgage in the chain of title to determine whether it secures future advances.
- Check to see if the state law or the loan agreement requires the borrower to surrender its credit card or checks as a condition to freezing the credit line account.
- Require the seller to terminate the line of credit early enough to allow the mortgage to fix the termination balance and give a firm payoff by surrendering its credit cards and checks or other means proscribed by state law.
- Once the credit line has been terminated and the amount secured by the mortgage has been limited to a specified outstanding balance in an instrument filed of record as provided by the terms of the mortgage or state open-ended mortgage statute, you can rely on a lender's payoff quote, plus the appropriate per diem, as if it is a conventional loan.

Sample "freeze" language to be inserted into written requests for payoffs:

"In the event this loan is secured by a Mortgage [Deed of Trust] allowing for advances of a credit line, please be advised that this letter authorizes you to freeze the referenced credit line upon issuance of your payoff [demand]. If you require further authorization, please contact the undersigned immediately. ***Payment pursuant to your payoff (demand) will eliminate any security interest you have in the property in question.*** *In order to avoid unsecured additional advances the account must be frozen upon issuance of your payoff [demand]. If you make any additional advances they will not be secured by the subject property. We will be completing an escrow/closing transaction involving a new owner or lender in reliance on the release of your security interest in the property. Upon payment you will be obligated to issue a release of the Mortgage [Deed of Trust] securing the line of credit."*

<u>SAMPLE Credit Line Authorization Form</u>

[insert return address for title unit]

LETTER OF AUTHORIZATION
TO:

____
Lender

____
Address

FROM: ____
Borrower/Seller

RE: Loan No. ___________________________________

Property Address: _______________________________

The undersigned hereby authorizes you to close the above referenced credit line account upon receipt of this notice.

I/we agree to pay any charges pending that may not be reflected on the demand for payoff issued to the title insurance company and I/we agree to cease activity on this account.

Upon receipt of funds representing payment in full, you are to forward the full reconveyance to:
____, as per their instructions.

____
Borrower/Seller Date

Hospitals And Health Facilities

Government Grants

The Hill-Burton Act, the Health Research Facilities Act, the Health Professions Educational Assistance Act, the Nurse Training Act, the National Health Planning and Resources Development Act, the Special Health Revenue Sharing Act and the Developmentally Disabled Assistance and Bill of Rights Act provide that funds advanced thereunder may be recovered on the happening of certain events not only from the original applicant but also from a transferee of such applicant. An exception, such as that suggested below, should be raised where our examination discloses that The Land is or has been used for any of the purposes described in the aforesaid acts.

The “Hill-Burton” Act (42 USCA Sec. 291 et seq.) authorized the US to make grants of public funds to states to assist them in programs for construction and modernization of public or other non-profit community hospitals and other medical facilities that may be necessary. All funds are paid to the states and they, in turn, disburse to qualified applicants. State administration of the “Hill-Burton” funds requires the passage of enabling legislation in the states.

Of importance to us with respect to federal giants is section 291 (i) of the “Hill-Burton” Act which provides as follows:

"If any facility with respect to which funds have been paid under section 291f of this title shall, at any time within twenty years after the completion of construction--

(a) be sold or transferred to any person, agency or organization (1) which is not qualified to file an application under section 291e of this title, or (2) which is not approved as a transferee by the State agency designated pursuant to section 291d of this title, or its successor, or

(b) ceases to be a public health center or a public or other non-profit hospital, outpatient facility, facility for long-term care, or rehabilitation facility, unless the Surgeon General determines, in accordance with regulations, that there is good cause for releasing the applicant or other owner from this obligation, the United States shall be entitled to recover from either the transferor or the transferee (or, in the case of a facility which

has ceased to be public or non-profit, from the owners thereof) an amount bearing the same ratio to the then value (as determined by the agreement of the parties or by action brought in the district court of the United States for the district in which the facility is situated) of so much of the facility as constituted an approved project or projects, as the amount of the Federal participation bore to the cost of the construction or modernization under such project or projects. Such right of recovery shall not constitute a lien upon said facility prior to Judgment."

Similar provisions will generally be found in the state legislation enacted pursuant to the Federal law. The Acts impose restrictions on the alienation of the facilities' titles to the extent that grants made thereunder are converted into debts in the event any recipient of a grant ceases to be a non-profit or public hospital or facility or sells or transfers to a non-qualified person, agency or organization within the statutory period. Therefore we have taken the position that our title commitments/policies require a disclosure of the existence of the rights of the US and the State where disbursements were made pursuant to the terms of the acts.

Where the examination of title discloses that any public or other non-profit community hospital or other facility as noted above (a non-profit retirement home may fall within this category) is in title or has held title since the passage of the "Hill-Burton" Act (effective August 17, 1946) or the applicable state law the following exception should be reflected on the commitment/policy:

Rights of the USA and the State of________ or either of them to recover any public funds advanced under the "Hill-Burton" Act (Title 42 USCA Sec. 291 et seq.) or any state statute enacted pursuant thereto.

The exception may be waived for Policy on satisfactory evidence that the facility is not the recipient of any such funds but must be reconsidered on the continuation of said title. With the sale and consolidation of facilities it may not be prudent to rely on an affidavit from the financial officer who may not have any knowledge of the grant funds received by the facility or its predecessor in the past. The web site of the Health Resources and Services Administration of the Department of Health and Human Services maintains a directory of obligated facilities. The address is: http://www.hrsa.gov/gethealthcare/affordable/hillburton/facilities.html . This list should always be checked when examining hospital property.

Other Federal Acts
Several other federal acts provide federal assistance for a variety of health programs and contain recovery provisions similar to those contained in the Hill-Burton Act. They are:

Research Facilities in Sciences Related to Health 42 U.S.C. Sec. 292 *et seq.,* Section 292f provides for federal grants for the construction of health research facilities.

Teaching Facilities for Training Physicians, Pharmacists, Optometrists, Podiatrists, Veterinarians, Dentists and Professional Public Health Personnel, 42 U.S.C. Sec. 293 *et seq.,* provides for grants, loan guarantees and interest subsidies for the construction of teaching facilities for medical, dental and other health personnel.

Schools of Nursing, as amended, 42 U.S.C. Section 296 *et* seq., provides grants for the construction of facilities for nurses training.

The National Health Planning and Resources Development Act of 1974, Public Law 93-641, 42 U.S.C. Section 300k *et seq.,* provides allotments, loans, loan guarantees, interest subsidies and grants for the modernization of medical facilities, construction of new outpatient medical facilities, construction of new inpatient medical facilities in areas which have experienced recent rapid population growth and conversion of existing medical facilities for the provision of new health services. The term "medical facility" is defined in this act to include a hospital, public health center, outpatient medical facility, rehabilitation facility for long term care, or other facility for the provision of health care to ambulatory patients.

The Special Health Revenue Sharing Act of 1975, Public Law 97-63, 42 U.S.C. Sec. 2689 et *seq.,* provides allotments for the acquisition or remodeling of facilities for community mental health centers.

The Developmentally Disabled Assistance and Bill of Rights Act, Public Law Sec. 94-103, 42 U.S.C.6002 *et* seq., makes provisions for grants to university affiliated facilities and allotments to the states to provide services for persons with developmental disabilities. Such a facility may be part of a college or university or be affiliated with it.

Higher Education Facilities Acts of 1963 and 1965 (20 U.S.C. 702 et seq)

Architectural Barriers Act of 1968 (20 U.S.C. 1132D-11 et seq)

Training Facilities For Allied Health Professions Personnel (42 U.S.C. 295 et seq)

Mental Retardation Facilities and Community Health Centers (42 U.S.C. 2693 et seq, 42 U.S.C. 6006 et seq)

Community Health Centers (42 U.S.C. et seq)

Multipurpose Senior Centers (42 U.S.C. 3041 et seq)

If our examination discloses, either through the title finding or other material in the file, that the property is or has been used, since the passage of any of the acts discussed above for one or more of the uses described in such acts, the following exception should be raised:

"Rights of the United States of America to recover any public funds advanced under the provisions of one or more various federal statutes relating to health care."

The public records for the property will probably not disclose its use as a health care or health education facility. There will probably be no indication whether public grants were obtained for the initial construction or subsequent remodeling. Sometimes the initial financing will contain a paragraph related to Hill-Burton (or similar) obligations, since that issue also affects the lender of construction or purchase financing.

Any public or non-profit related school, hospital, or property devoted to health-related research may have received public funds. Investigation should focus upon the use of the property when build, the source of funding its construction or remodeling and the number of years that have passed since that funding. That investigation may reveal that the property was built as a ”for profit” facility, with no public funding. It is also possible that the investigation will not reveal enough information to be sure that no public funds were used, requiring the potential issue to remain as an exception. The exception may be waived for policy on satisfactory evidence that the facility is not the recipient of any such funds but must be reconsidered on the continuation of said title.

There may be State acts that also grant reimbursement liens. You should verify with your Company underwriting advisor if there are any in your state.

Indian Lands

THE UNITED STATES CONSTITUTION DELEGATES AUTHORITY OVER INDIAN MATTERS TO THE FEDERAL GOVERNMENT. THIS HAS BEEN IMPLEMENTED IN TREATIES AND FEDERAL LEGISLATION. AN IMPORTANT FEATURE OF FEDERAL LAW IN THIS REGARD IS THAT INDIAN TRIBES HAVE THE STATUS OF A FOREIGN NATION, BUT THIS SOVEREIGN AUTHORITY IS UNDER THE PROTECTION OF THE FEDERAL GOVERNMENT.

Federal statutes commonly known as the Non-Intercourse Acts, first enacted in 1790, provide that tribes may not sell their lands to anyone unless the sale is federally approved. The present version is 25 U.S.C. 177. The government has delegated the power of approval to the Secretary of the Department of Interior, who has in turn delegated to the Director of the Bureau of Indian Affairs (BIA).

Indian tribes and individual Indians may have their interests in real property insured, whether the land is located inside or outside of a tribal reservation, provided that certain underwriting requirements are met.

Reservation Land

Indian tribes have been provided with tracts of reservation land pursuant to treaties and implementing statutes. The Supremacy Clause of the United States Constitution makes treaties and federal statutes preemptive of state assertions of jurisdiction. Some federal laws have delegated to certain states jurisdiction of certain matters within "Indian country," that is, on a tribal reservation. Some states were required to disclaim jurisdiction over Indian country lands as a condition of their admission to the union.

Indian tribes have power to regulate lands within their reservation similar to the power vested in the state. For that reason, whenever insured property is located within or near the boundaries of an Indian reservation, a note in substantially the following form is appropriate:

NOTE: The property described herein is or may be located within the boundaries of the __________ Indian Reservation. The government powers referenced in paragraphs 1 and 2 of the Exclusions from Coverage of this policy include, in addition to governmental entities, the __________ tribe.

Tribes are permitted to own land. Reservation land, set aside pursuant to treaty or statute, may be vested in the tribe or in the United States in trust for the tribe. Any conveyance or mortgage of the land owned by a tribe must be approved by the BIA. Tribes may also acquire land outside the reservation, either in trust status (requires BIA approval), or non-trust status.

Increasingly, Indian tribes have purchased land outside the reservation for economic development of the tribe and employment opportunities for tribal members. Such development may be for a usage which would be highly regulated, taxed, and/or prohibited if it were within the jurisdiction of the state. A gambling casino would be an example. The state, county or municipal government may seek to attack the acquisition to avoid loss of regulatory or taxing authority. Accordingly, if an order is placed for acquisition by a tribe of property and it further appears that a change in usage (for example, new construction) is intended, it is necessary to confer with your Company underwriting advisor. This underwriting rule applies whether the land is to be acquired in trust status or non-trust status.

Trust Titles And Tax Exempt Status

Trust status is another important feature of ownership by Indian tribes or individual Indians. There are three ways that an individual Indian can own land: (1) unrestricted fee, (2) restricted allotment or restricted patent ("restricted fee"), or (3) trust allotment or trust patent. Unrestricted fee is just that, not any different from fee simple of a non-Indian. Restricted fee titles are subject to a restraint against alienation in favor of the United States, contained in the federal patent or deed, and which restraint runs with the land. Trust allotment or trust patent titles may have taxation and other advantages. An individual Indian owning land in unrestricted fee title may elect to convert ownership to trust status by conveying the land, whether on a reservation or not, to the United States in trust for that Indian. The chain of title may include conveyances where the land is held variously in and out of trust status (see BIA trust status reports below). See also the discussion below of the exception to raise when the BIA agrees to acquire or hold land in trust.

Note: Who is an Indian? Federal law will determine whether an individual is deemed an Indian. In the vast majority of instances where this may be an issue, we will be informed at the outset of the order. It is not necessary to inquire further if the individual buyer, seller or borrower is so identified. If we have not been informed that an individual Indian is involved, it is not necessary to ascertain whether this may be so.

Prior taxes shown on the tax rolls that may be unpaid or delinquent at the time of the conveyance into trust status should be shown as an exception until the County Treasurer removes them from the tax warrants. Once that is done, it is appropriate to note the exempt status on commitments. No insurance is to be provided on any land where the title of a previous Indian owner has been purportedly lost by tax foreclosure. Lands owned by a tribe within a reservation generally are not taxable except as specifically dealt with in federal statutes. Lands held by the United States in trust for a tribe are not taxable. Land owned by a tribe, or in trust for a tribe, which land is not located on a reservation may or may not be taxable.

BIA Title Status Reports

Two searches of "public records" must be made when insuring ownership or mortgages by individual Indians, by tribes or tribal corporations or by non-Indians on reservation lands: the local county records and records of the BIA.

Title records for lands patented or conveyed to an individual Indian or a tribe in restricted fee or to the United States in trust status for an Indian or a tribe are kept in the offices of the BIA. It is necessary to order and examine a Title Status Report (TSR), which is currently certified by the BIA, together with copies of all encumbrances, in order to complete a title search. Exceptions to title should reflect both searches, the TSR and the county records. Unless the county records reflect a connected chain of title, consistent with the TSR, title should be shown vested in the last owner of record according to such county records. A "right, title and interest" exception should be added to reflect the last owner of record according to BIA records. "Confirming" conveyances must be recorded in the county records. Certified copies of conveyances shown in the TSR can be obtained and recorded in local recorders' offices. It may be possible to record a certified TSR itself and, with approval from your Company underwriting advisor, to rely on the TSR to insure title as therein shown.

Depending on the regional BIA office involved, it may be necessary to obtain a second TSR from the central (Washington, D.C.) BIA. Confer with your Company underwriting advisor.

Insuring Mortgages By Indians And Tribes

In view of the sovereign authority which an Indian tribe has, an exception must be raised on all commitments and policies insuring a mortgage made by a tribe, tribal corporation, or an individual Indian on reservation land:

Notwithstanding paragraph 5 of the Insuring Provisions, this policy does not insure (i) that the lien of the insured mortgage described in Schedule A may be foreclosed non-judicially pursuant to state law, nor (ii), in what court, state, federal or tribal court an action may be brought to foreclose the insured mortgage, nor will the Company pay costs, attorneys' fees or expenses to determine what court has jurisdiction to foreclose the insured mortgage.

Federal statute 25 U.S.C. §483(a), provides that: "The individual Indian owners of any land which either is held by the United States in trust for them or is subject to a restriction against alienation imposed by the United States, are authorized, subject to approval by the Secretary of Interior, to execute a mortgage or deed of trust to such land. Such land shall be subject to foreclosure or sale pursuant to the terms of such mortgage or deed of trust in accordance with the laws of the tribe which has jurisdiction over such land or, in the case where no tribal foreclosure law exists, in accordance with the laws of the State or Territory in which the land is located."

For mortgages executed by a tribe or a tribal corporation, whether or not the land is on a reservation, the insurer must consider the issue of sovereign immunity. The doctrine of sovereign immunity provides that neither the United States nor any state may be sued without its consent. The United States Supreme Court has held that Indian tribes, in a similar manner, enjoy sovereign immunity from suit in state or federal court. An exception must be raised for the consequences of the tribe's sovereign immunity, unless it can be determined that it was satisfactorily waived.

Congress has the power to do so, but has not yet enacted any blanket waiver of tribal immunity. Tribes cannot waive their sovereign immunity in matters affecting trust property without the approval of the BIA. The United States Supreme Court has not directly addressed whether, for non-trust property, Congressional approval is necessary to support a tribe's waiver of sovereign immunity. Some lower courts have viewed an unequivocal waiver by a tribe as effective. The question of our willingness to rely on a purported waiver of a tribe's sovereign immunity must always be referred to your Company underwriting advisor.

Tribal Corporations

Tribal corporations under the Indian Reorganization Act (25 U.S.C. 461 et seq.) sometimes are chartered with clauses authorizing the corporation to sue and be sued. This may constitute a waiver of any sovereign immunity which the tribal corporation may have. Such corporations are likely to be deemed by the law to possess sovereign immunity to begin with, insofar as they are wholly owned by the tribe, or might be construed by a court as functioning as "an arm" of the tribal government. Immunity claims may depend upon whether the corporation serves a particular tribal purpose. Any doubts should be resolved by treating the tribal corporation as possessing sovereign immunity and requiring the BIA approval of waiver thereof. It may be possible for Regional Counsel, after review, to view waiver as insurably clear.

BIA Approval of Acquisition of Non-Reservation, Non-Trust Title by Tribe

Increasingly, tribes acquire interests in non-reservation property, do not seek trust status, and assert that they do not need BIA approval to do so. Issuance of an Owner’s Policy insuring such a tribal acquisition should take into account that any action by the insured tribe afterward, such as mortgaging, leasing, granting easements or conveying, will require the BIA’s approval. The question of whether, therefore, to raise an exception on Schedule B, for these post-policy restrictions on free alienability, should be referred to Regional Counsel. Any indication of imminent post-policy change in usage or status of title should be taken into consideration.

Risk of Adverse Claims

Title insurers have, over the years, been faced with a number of claims involving assertions of the rights of Indian tribes, under theories of aboriginal title or otherwise, which assertions are adverse to the current non-Indian ownership. When appropriate, the Company's Regional Counsel will direct that commitments or policies must contain an exception concerning those asserted rights.

Indian Trust Land Exception

Please be familiar with the following exception and the reason why it has been raised.

"Any assertion that the acquisition by the United States in trust for the _______ [tribe] was without authority"

Since the case of South Dakota v. United States Department of Interior (69 F.3d 878 (8th Cir.1995), vacated 519 U.S. 919 (1996), we have raised the above exception whenever the U.S. acquires property in trust for a tribe and gambling is a potential usage. The U.S. Supreme Court did not clearly reverse the holding by the 8th Circuit that the 1934 Indian Reorganization Act (IRA) was unconstitutional. We continued to take this position notwithstanding a later, useful decision from the 10th Circuit, which upheld delegation to the BIA under that Act (U.S. v. Roberts (185 F. 3d 1125) (10th Cir. 1999). The prudence of our policy is illustrated by the protracted actions by the State of Rhode Island, and its recent success, after it believed that acquisition in trust for the Narragansett Tribe would ultimately lead to gambling usage.

The U.S. Supreme Court, on February 24, 2009 decided in favor of the State in litigation that began with an acceptance in trust in 1998, fully 11 years previous (Carcieri v. Salazar (129 S.Ct. 1058) 2009).The Court ruled that the IRA was not applicable to the Narragansett Tribe because, although the tribe existed in 1934, it did not gain formal recognition as a tribe until 1983. While the State itself had earlier (in 1978) settled a dispute with the tribe, a subsequent acquisition led the State to fear that trust status would enable the tribe to apply under IGRA (see below) for a permit to operate a gambling facility.

IGRA (the federal Indian Gaming Regulatory Act), at 25 U.S.C. 2719(a), provides that gaming shall not be conducted on lands acquired by the U.S. in trust (acting through the Department of Interior, which in turn acts through the Bureau of Indian Affairs—BIA) after 10/17/1988 unless the land is located on or contiguous to the tribe's reservation, or within the tribe's last recognized reservation in such State. Sec. 2719(b) then excepts lands from the application of (a) when the BIA, "after consultation with the Indian tribe and appropriate State and local officials…determines that a gaming establishment on newly acquired lands would be in the best interest of the Indian tribe and its members, and would *not be* detrimental to the surrounding community, but only if the Governor of the State in which the gaming activity is to be conducted concurs in the [BIA's] determination. [Emphasis added to show that the Governor has a veto for gaming usage]. IGRA then goes on to recite that nothing therein "shall affect or diminish the authority and responsibility of the [BIA] to take land into trust."

Many States continue to oppose gaming proliferation under IGRA in their states, but also oppose taking property into trust *regardless of usage* because of loss of tax revenue and zoning and other regulatory and police control over property so taken. The Rhode Island resistance is instructive. In 1998, the State of Rhode Island and the Town of Charlestown were notified by the BIA that the Narragansett Indians tribe intended to convey into trust a parcel of land purchased by the tribe in 1988. Fearing ultimate gaming usage, the State and Town asked the BIA to put a usage restriction on title, which the BIA declined to do. The property was adjacent to the tribe's reservation, falling within 2719(a). The tribe stated that it wanted to build housing for its members. In federal District Court, the State argued that the 1934 IRA was unconstitutional in the following three ways and therefore the acquisition was invalid:

1. Acquisition in trust under IRA is an unconstitutional *delegation of power to* the BIA. They cite the South Dakota case, above, even though the 8th Circuit decision had been vacated. The District Court (in ruling against the State) correctly stated that that case had been vacated and remanded, but without any published reasoning. The District Court then cited the 10th Circuit Roberts case (above), which upheld the delegation, noting that the statute itself placed "ample limits on the BIA's exercise of discretion."

2. Acquisition into trust is volative of the Enclave Clause (Article I, Section 8, Clause 17 of the U.S. Constitution), which precludes the federal government from establishing within a state an enclave which is exclusively subject to federal jurisdiction. This argument was rejected by the District Court, which stated: "checkerboard jurisdiction is not novel in Indian law."

3. Tenth Amendment is violated, the state's sovereignty is diminished without its consent and acquisitions under IRA exceed the powers granted in Article I, section 8, Clause 3, the so-called Indian Commerce Clause. This position was also rejected by the District Court, citing the Roberts case.

The District Court decided in favor of the BIA and tribe (Carcieri v. Norton, 290 F.Supp.2d 167 District Rhode Island 2003). Affirmed by the Appeals Court (398 F.3d 22, 1st Cir. RI 2005). On rehearing, affirmed (423 F.3d 45, 1st Cir. RI 2005), opinion withdrawn by, vacated by, rehearing en banc granted by 1st Circuit, Dec. 5, 2006 (2006 LEXIS 32432). Opinion replaced by en banc 497 F.3d 15 (1st Cir. 2007). Writ of certiori granted, motion denied by 128 S.Ct. 1443 (U.S. 2008), Motion granted by 129 S.Ct. 18 (U.S. 2008), motion denied by 129 S.Ct. 338 (U.S. 2008), reconsideration denied by 129 S. Ct. 486 (U.S. 2008).

All of these losses did not discourage the State from, just one month from losing the motion for reconsideration, raising a new theory: that the tribe was not recognized in 1934. The Supreme Court *reversed*, now ruling in favor of the State of Rhode Island, by 129 S.Ct. 1058 (February, 2009).

<u>The litigation history itself suggests the prudence of raising an exception.</u>

Islamic Financing

MANY MUSLIM BORROWERS ARE OF THE BELIEF THAT THEY CANNOT PARTICIPATE IN FINANCING UNLESS IT IS "SHARI'AH" COMPLIANT SO AS TO CONFORM TO PRINCIPLES OF ISLAM WHICH PROSCRIBE CERTAIN ELEMENTS OF FINANCING WHICH ARE USUAL FEATURES OF WESTERN TRANSACTIONS.

These features are

- the charging of interest, and
- the payment of rent on a new construction project before the improvement has reached a particular stage of usefulness or occupancy.

To make sure that a financing format complies with Islamic law, a board of clerics reviews transaction structures and documents. That same board will determine, on a case-by-case basis, at what point the improvement is sufficiently complete or economically viable to allow rent to be paid.

The following are formats which we have considered for title insurance.

Financing lease ("Ijara")
The use of a lease as a vehicle for Islamic financing is, in many ways, parallel to the documentation of synthetic lease transactions, but with a completely different motivation. In both, the lender provides funds through a special purpose entity ("SPE") lessor. The Muslim borrower has the status in the document of a lessee. The intention of the parties is that the borrower is the owner of the property. The intention is that the borrower/lessee has complete possession and control over the property and its uses. The obligations of the Muslim borrower, however, will vary from conventional obligations.

The "finance lease" is called an ***ijara (NOTE: Use of Islamic terminology for documentation is important to and is required by the Insureds. For instance, the finance lease will be referred to in Schedules A and B as "Finance Lease (Ijara)").***

Title insurance policies can be issued to the entities on the financing side as well as to the borrower. It is appropriate for the insurer to carve out the consequences of any assertion that the interests of the parties are recharacterizable in equity. A Schedule B exception can be raised:

> *Consequences of any assertion that the relationship between ______[lessor] and _______[lessee] is anything other than that of lessor and lessee.*

Similarly to synthetic lease financing, issuance of multiple policies requires special attention to “liability non-cumulative” exposure. Typically, the Muslim borrower finds a home and the lender, through its SPE, purchases the home and enters into the finance lease with the borrower. However unlike in a synthetic lease, the borrower is not prohibited from owning any interest in the property before entering into the financing lease. Thus, prior to the conveyance to the SPE, title can already be in the borrower, or the borrower may buy the property and the financing lease may include acquisition funds.

<u>Ijara as construction vehicle</u>.

For a construction loan, the Muslim borrower leases to an SPE (hereafter SPE-Lessor) which lease functions as a ground lease and gives the SPE-Lessor title to contemplated improvements (subject to state law on severance of title to improvements). The SPE-Lessor will enter into (1) a construction agreement, called an ***istisna’a***, with another SPE entity (SPE-Arranger), (2) a Managing Contractor Agreement with the borrower which addresses performance of construction supervision, acceptance and structural maintenance, (3) an Agreement to Lease the Improvements to the borrower and (4) a Lease (Ijara) of the Improvements back to the borrower. Each must be reviewed for shari’ah compliance by the clerical board. Obligations of Muslims for rental payments, under shari’ah, are not to begin until the project is sufficiently completed-- a sufficiency to be determined by the shari’ah board of clerics. Your Company underwriting advisor will need to determine whether a lease can insurably be deemed to commence before the lessee is in possession or is obligated to pay rent in your state.

There might be Islamic parties participating on the funding side as well, which is the reason for the SPE-Arranger. The SPE-Arranger, which has no Muslim component participation, enters into the construction contract with the general contractor. The Agreement for Lease of the Improvements allocates structural maintenance and delays liability of the lessee under the Lease (Ijara) to pay rent until the point of shari’ah-determined progress. Thus, until that point of sufficient completion, no Muslim is obligated.

The SPE-Lessor will, as the owner of the improvements, be used by the borrower to obtain a loan which generally will be secured by a mortgage or deed of trust. The mortgage or deed of trust will secure a loan agreement entered into by the SPE-lessor and thus may contain provisions which if entered into by a Muslim borrower might not be shari'ah compliant. The rental obligations of the Muslim borrower equal the debt service payable by the SPE-Lessor to the mortgagee.

Accordingly, policies can be issued to the mortgagee; to the SPE-lessor for its ownership of the improvements and ground leasehold interest; and to the borrower for its fee as well as leasehold for the improvements interests. The policy running to the SPE-lessor must contain a recharacterization exception, but we can provide the standard amelioration of that exception:

> *Consequences of any assertion or determination that (a) the Financing Lease referred to in exception _____ (hereinafter "Financing Lease")is not a "true lease" or (b) the vesting of title to the improvements in _____[SPE-Lessor] by the Site Lease referred to at exception ___ (hereinafter Site Lease) is part of a loan transaction, including an assertion that the Site Lease together with the Financing Lease constitutes a mortgage or other security device (a "Mortgage"). **Provided , however, that in the event of a final determination by a court of competent jurisdiction that such Site Lease and/or Financing Lease creates a Mortgage from ____ [borrower/site lessor] in favor of ____ [SPE-Lessor], with a priority date as of the original Date of Policy hereunder, the Insured shall have all of the rights of an Insured under an ALTA Loan Policy (6/17/06), insuring said Mortgage as a lien against the land and improvements as of Date of Policy with an Amount of Insurance of $__________, subject to no exceptions other than those set forth in Schedule B and the Insured Mortgage.*

NOTE: language after ** should, in most jurisdictions, be incorporated into an endorsement, where available, which begins *"Notwithstanding Schedule B exception number ___, in the event of a final determination….."*

It should be noted that the language requiring the court determination itself to set forth the relating back priority obviates the need to have "lien granting" language in the Site Lease, as would be usual case in synthetic leases for this kind of coverage. The policy for the mortgagee does not require such an exception for recharacterization if the Muslim borrower has insurably subjected their interest to that of the mortgagee. Your Company underwriting advisor will review how this can be done.

The policy to the SPE-Lessor will also contain exceptions for the Agreement to Lease and any put or call options, which we have seen used to reflect the rights of the borrower to either buy out the SPE-Lessor, or be contractually obligated to do so. In those jurisdictions where coverage may be afforded for optionees of real property interests, the borrower's interest might qualify if state underwriting guidelines and requirements for such coverage are met.

The borrower's policy, which would cover the fee title and also the leasehold in the improvements, requires special attention to the nature of the Islamic law with respect to obligation to pay rent on new improvements. While it may be problematic under state law to insure a lease in which the lessee has not begun paying rent at date of policy, we have insured such leases if it is clear that the lease has commenced notwithstanding that the obligation to pay rent is in abeyance. State law on this issue must be reviewed.

Ijara as non-construction loan vehicle

The ijara format can also be used as a refinancing vehicle similar in nature to a sale-leaseback, where the Muslim Borrower conveys the land to the SPE-Lessor, who leases it back and simultaneously as fee owner, enters into a loan agreement and executes a security document to secure the loan comparably to that described above. The key for the Muslim borrower is that no Muslim is involved in the loan agreement, which will contain interest provisions which are not Shari'ah compliant.

CO-OWNERSHIP or diminishing musharakah ("*Musharakah")*

Islamic law distinguishes the charging of interest from the division of revenues or profits in a co-ownership arrangement if (1) the party receiving payments has an ownership interest, and (2) if the payment obligation is limited to amounts that can be derived from the property itself and is not a recourse obligation. In one structure we have seen, the Muslim borrower arranges to have title conveyed to themselves and to a limited liability company ("Co-Owner") which is affiliated with the lender. The deed will not specify the respective percentage ownership interests of the borrower and the Co-Owner. The deed will, instead, reference a Co-Ownership Agreement, which will have a schedule that changes the ownership percentages as payments are made. Similarly to an installment contract to purchase land, after making the final payment the borrower is entitled to have the Co-Owner deliver a recordable deed.

At the closing, the borrower will execute the Co-Ownership Agreement and also an Obligation to Pay instrument and a Mortgage or other security instrument. The Obligation to Pay running from the borrower to the Co-Owner, gives the latter foreclosure rights. The instrument states that it is secured by a Mortgage or other Security Instrument, which runs in favor of the Co-Owner. The borrower may not convey or sell their interest without the consent of the Co-Owner, and to do so is a default under the Obligation to Pay. The borrower is to have the sole right to occupy the land, while the rights of the Co-Owner and their assignee are intended to be the same as those of a traditional lender. The borrower pays all taxes and expenses. Their obligations are non-recourse. The intention is that the Co-Owner may assign their interest.

The Mortgage or other security instrument secures the obligations under the Obligation to Pay. The Co-Owner will be the mortgagee. The Co-Owner then assigns their rights under all of the instruments to the funding lender, of which the Co-Owner is an affiliate, by an Assignment and Amendment of Security Instrument. In that same instrument, the Co-Owner grants a mortgage to the assignee, and the borrower agrees that their interest is subject to the lien. In so doing, all of the property will be encumbered. We can provide title insurance to all of the parties reflecting their record interests. These policies will reflect (on Schedule B) the terms and provisions of the Co-Ownership Agreement and Obligation to Pay instruments referenced by the recorded documents. The program we have seen, described above, was designed to create security instruments acceptable to Fannie Mae and other investors. Musharakah can be spelled musharaka, or referred to as a diminishing musharaka.

LENDER FLIP AT MARK-UP PRICE (*“Murabahah” or “Murabaha”)*

Another format for financing, without the charging of interest, which may be presented to us without indication that it involves Islamic principles, involves a lender, at the direction of a Muslim borrower, buying the property outright from a seller, and re-selling it to the Muslim borrower at a profit consistent with what it makes on traditional loans—at a mark-up, in commercial terms.

It has been described as a “cost-plus sale.” The bank’s profit is pegged to what the lender earns on typical fixed-rate mortgages over a negotiated time frame. Once the lender sells to the borrower, any appreciation of the value belongs to the borrower. The obligation to repay the lender might be secured by a mortgage or deed of trust, but no “interest rate” will be involved, the obligation having already taken into account the yield that the lender desires. Title insurance of such a transaction does not present any unusual problems. Nothing about the deed from the lender to the borrower, or the borrower’s lien to the lender will require any special treatment from the insurer.

We have seen Murabahah agreements where refinancing is accomplished for a borrower who already owned the property and wished to leverage it. Other than the fact that the deed to the lender will come from the borrower (followed by a deed back to the borrower with a mortgage to secure the “Murabahah debt”) the format is the same as above. The Murabahah debt is calculated to include the profit negotiated by the lender and equal installments repay that debt, plus amounts for required insurance and for real estate taxes. (in the July/August 2008 issue of Business Law Today (American Bar Assn. Business Law Section), an article entitled “Islamic Banking—an introduction” includes a paragraph on Murabahah. It is included as an exhibit at the end of this memo. Murabahah can be spelled as Murabaha.)

INSTALLMENT CONTRACT

Comparable to the several of the above formats, we have also seen Muslim borrowers enter into a contract to purchase the land. We have endeavored to insure the interest of the Muslim vendee as an interest covered by the policy virtually identically to the manner of insuring non-Islamic vendees, in jurisdictions where such insurance is available. In one jurisdiction, we issued an endorsement which insured against loss by reason of the refusal of the seller or their successor to deliver a deed after the buyer had complied with the contract, subject to the consequences of the buyer’s failure to do everything necessary to secure deeds, releases from persons then having an interest in the land, and to secure if necessary a court order which determines to whom to make the final payment. It is noteworthy that the request for insurance in this case was described as “Islamic financing,” but no Islamic terminology was used in any of the documentation that enabled our insurance.

Additional resources:

[from article by Shahzad Q. Qadri in Business Law Today, July/August 2008 edition:]

> **“Murabahah**
> This concept refers to the sale of goods at a set price, which includes a profit margin agreed to by both parties. The purchase and selling price, other costs, and the profit margin must be clearly stated at the time of the sale agreement. The bank is compensated for the time value of its money in the form of the profit margin. This is a fixed-income loan for the purchase of a real asset (such as real estate or a motor vehicle), with a fixed rate of interest equal to the profit margin. The bank is not compensated for the time value of money outside the contracted profit margin. This concept is widely utilized in Islamic mortgage transactions. In such transactions, instead of loaning the buyer money to purchase the property, the bank might buy the property itself from the seller, and then re-sell it to the buyer at a profit, while allowing the buyer to pay the bank in installments. However, the fact that it is profit cannot be made explicit and therefore, there are no additional penalties for late payment. In order to protect itself against default, the bank requires strict collateral. However, the goods or land is registered in the name of the buyer from the start of the transaction, and accordingly, the buyer is in fact able to benefit and receive tax credits.”

See also article in July 12, 2012 edition of the New York Law Journal, entitled “Islamic Finance and Investment in U.S. Expected to Grow,” by Michael J.T. McMillen.

Leases

Leases and Leasehold Insurance

LEASES, OPTIONS TO PURCHASE, AND OPTIONS TO RENEW SHOULD BE RAISED AS SPECIFIC EXCEPTIONS. AT THE TIME A LEASEHOLD IS CREATED IT IS SUBJECT TO ALL THE LIENS, DEFECTS AND ENCUMBRANCES WHICH AFFECT THE FEE TITLE. IT IS NECESSARY TO MAKE AN EXAMINATION OF BOTH THE FEE AND LEASEHOLD TITLE BEFORE INSURING A LEASEHOLD ESTATE. BEFORE INSURING AN ASSIGNMENT, DETERMINE THAT ALL RESTRICTIONS AND CONDITIONS IN THE LEASE OR OTHER DOCUMENTS HAVE BEEN COMPLIED WITH. A SUBLEASEHOLD ESTATE WILL BE SUBJECT TO THE EXCEPTIONS RAISED ON THE FEE AND UNDERLYING LEASEHOLD ESTATE. BEFORE WAIVING AN EXPIRED LEASEHOLD, REQUIRE PROOF THAT THE LESSEE HAS VACATED THE PREMISES.

Leases as Exceptions

Leases which appear of record in full, in short form, or as a memorandum, or which we become aware of through other sources must be shown as exceptions in Schedule B. The following exception would be appropriate where the lease is of record:

> *Lease and terms and provisions thereof between __________, lessor, and __________, lessee, dated __________, and recorded __________, as Document Number ______, in Book ______, Page ______, leasing the premises in question for a term of ______ beginning __________, and ending __________, and all rights thereunder of, and all acts done or suffered thereunder, by said lessee or by any party claiming by, through, or under said lessee.*

Where there are parties in possession by virtue of unrecorded leases, the following exception would be appropriate:

> *Rights of ________________ now in possession of the land under an unrecorded lease, and all parties claiming by, through, or under said lease.*

You may be able to make a general exception as to the rights of tenants in commercial buildings without specifying the name of each tenant and the space which the tenant occupies but only if you are certain that none of the tenants have other rights as under an option to purchase, contract to purchase, right of first refusal, etc. For example:

> *Tenancy rights of persons now in possession of all or a part of the land, with no options to purchase or rights of first refusal*.

In the event that the lease contains an option to purchase or an option to renew, a specific exception should be made as follows:

> *Option to purchase the premises in question in favor of __________, given in the lease dated __________ and recorded __________, as Document Number ________, in Book ______ Page _______.*

> *Option to renew contained in lease dated __________ and recorded _________, as Document Number ______, in Book ______, Page _____.*

Examination of Leasehold

A leasehold estate is an estate which is “carved out” of a fee estate. At the time the leasehold is created, it is subject to all the liens, defects and encumbrances which affect the fee title. It is necessary to make an examination of both the fee and leasehold title before insuring a leasehold estate.

Please review the Endorsement Manual Section 13 for further discussion of these topics.

Lessor’s Title

1. Examine the fee title at the date of the creation of the lease.

2. Determine that there are no conditions or limitations on the fee title which would prevent or cause defects in the creation of the leasehold estate.

3. If a trustee holds the fee title, determine that the instrument creating the trust gives the trustee the power to make the lease.

4. Question the power of a trustee to make a lease which is to extend beyond the termination date of the trust unless supported by a specific grant of authority by the trust agreement or an order of court.

5. If the lessor is a corporation, determine that the corporation has the power to make the lease in question and require proper resolutions and, where necessary, stockholder approval for the making of the lease.

Once the leasehold estate is validly created, the fee title is subject to the leasehold estate.

Lessee's Title

1. Determine that the leasehold is validly created and that the lease, or memorandum thereof, is in recordable form.

2. Search the lessee for judgments and other matters which may affect lessee's title.

3. If the leasehold is not presently being created, but some other activity is being insured, such as an assignment of lease or mortgage of the leasehold estate, require an estoppel statement from the fee title holder. The requirement might read as follows:

> *Furnish a written statement from the owners of the fee title of the premises in question stating that there is no default in the payment of rent, that there are no defaults under any other covenants or provisions of the lease, that there are no charges which the fee owner claims as a lien against the leasehold estate, and that the lease is in full force and effect.*

Assignment of Lease

Determine that all restrictions and conditions in the lease or other documents concerning assignments have been complied with. It is most common in long-term leases to find as a requirement that an assignment be approved in writing by the lessor. The requirement to be raised in the commitment should read:

> *Furnish a written statement by the fee owners recognizing the validity of assignment(s) (identify) and stating that compliance has been had with the requirements as to assignment(s) of the lease.*

Subleases

Where only a part of the leasehold term is transferred by the lessee, and lessee retains some part of the reversionary interest, it is generally a sublease. The sub-leasehold estate will be subject to the exceptions raised on the fee and underlying leasehold estate.

Termination

You may be asked to insure a fee title to real property free and clear of a lease on the theory that the leasehold is no longer in existence because of expiration of term, forfeiture, abandonment or for some other reason.

A lease that has expired by its terms has no legal existence. Before waiving a lease because of expiration of time, examine the record to determine if other instruments recorded after the lease extend or enlarge rights granted under the lease. A lease may contain an option to purchase or an option to renew. These should be raised as specific exceptions. Ascertain whether or not the option has been exercised. The following requirement should be raised:

> *Furnish evidence as to whether or not the option to purchase (option to renew) contained in the lease recorded in Book _____ Page _____ has been exercised and this commitment is subject to such additional exceptions as may be deemed necessary when such information is furnished.*

The lessee may have a right under the lease to the improvements on the premises at the termination of the lease or the right to be paid their value.

You should require proof that the lessee vacated the premises.

A leasehold estate may be destroyed by its merger into the reversion in fee when the leasehold and fee unite in one person. Courts apply the doctrine of merger only where the parties intend its application. Merger will not affect rights of third parties such as sublessees or mortgagees. In addition to having the fee and leasehold estates in one person, you should require that a declaration of merger be recorded, before waiving a lease by reason of merger.

Termination may result by surrender of the premises by lessee to lessor through mutual agreement of the parties. Require a formal declaration of surrender, signed by both parties, be placed of record.

Where a lease is terminated by the acts of the lessor, such as where the lessor declares a default for non-payment of rent, it is not safe to insure over a lease without a judicial determination that the lease is no longer in existence.

Leases

Recording of Short Form Leases

IF YOU ARE ASKED TO INSURE A LEASEHOLD ESTATE ON THE BASIS OF THE RECORDING OF A SHORT-FORM LEASE OR A MEMORANDUM OF LEASE, YOU SHOULD DETERMINE (1) WHETHER THE STATE STATUTE PROVIDES FOR THE RECORDING OF A SHORT-FORM LEASE AND, IF SO, (2) WHETHER THE CONTENT OF THE FORM IS SUFFICIENT TO MEET THE REQUIREMENTS FOR RECORDABILITY CONTAINED IN THE STATUTE TO CREATE AND GIVE NOTICE OF A LEASEHOLD ESTATE TO THIRD PARTIES.

We are often asked to insure a leasehold estate based on the recording of a short-form lease as opposed to the recording of the entire lease. The possibility of so insuring depends on how the following questions are answered:

1. Does the state statute specify that a short-form lease or a memorandum of lease is recordable?

2. Does this short-form or memorandum contain the elements required by the recording statute, if the statute contains such requirements?

3. If the statute does not specifically provide for the recording of a short-form lease or a memorandum of lease, does the short-form or memorandum contain all the elements of a lease?

A short-form lease or a memorandum of lease may not be recordable in jurisdictions that do not provide for them by statute. Consequently, the issue is whether the shortened form imparts constructive notice to third parties as to the terms of the lease so that we would be able to insure the estate against the claims of third parties.

What is the necessary content for short-form leases, or a memorandum of lease in states where they are not specifically authorized?

In states where a lease is identified as recordable, the memorandum would at least have the required elements of a lease. In states where “any instrument affecting” real property or any “conveyance” is recordable, the short-form would have to contain language that would “affect” or “convey” property.

Generally, a short-form or memorandum of lease must contain at least the following elements to be recordable and insurable:

1. a granting/demise clause;
2. a habendum clause;
3. an identification of the lessor(s) and lessee(s);
4. a description of the lands affected;
5. an indication of when lessee(s)’ possession is to begin;
6. an indication as to how or when lessee(s)’ term is to end;
7. a reference to the full lease which defines the rights of the parties; and
8. the memorandum should be dated, executed (by all parties) and acknowledged concurrently with the basic instrument in order to avoid the allegation that one instrument is a revision or a replacement of the other.

Any questions as to whether a short-form or memorandum in general, or a specific short-form lease, is recordable in your state should be referred to your Company underwriting advisor.

Further, when requested to insure a leasehold estate as noted of record by the recording of a short-form or memorandum of lease, an original or certified copy of the original lease, together with all amendments, should be produced for our review. This original or certified copy of the lease should be retained in our files. Upon review of the actual lease, special attention should be made for items such as landlord’s consent to any lease assignment or mortgage by the lessee, options to purchase, options to renew, and/or rights of first refusal. If any items are found, they should be noted in the policy.

Please review the Endorsement Manual Section 13 for further discussion of these issues.

Leases

Reliance on Possession as Notice of Lessee's Rights Where Lease Not Properly Recorded

*DO **NOT** RELY ON POSSESSION BY THE LESSEE TO PROVIDE NOTICE OF LESSEE'S RIGHTS IN THE ABSENCE OF THE RECORDING OF THE FULL LEASE OR, WHERE AUTHORIZED, A MEMO THEREOF.*

The recording of a short-form lease or a memorandum of lease in states which do not specifically provide for them by statute may not be proper. Furthermore, whether authorized or not, the failure to include conveying language in the recorded memorandum such as "leased" or "conveyed" as required by the recording statutes could constitute an improper recording of that document. The question arises whether we can rely on possession to insure a lessee's interest if the lease is not properly recorded or is not recorded at all.

It is a general rule of law that the possession of real property is a fact putting all people on notice as to the nature of the possessor's interests. However, some states have statutory provisions which clearly indicate that possession does not constitute notice.

Even in states where possession is notice, possession by a tenant may not be notice of any long-term rights he may possess. Several states have special provisions in their recording acts that require leases over a specified number of years to be recorded in order to be effective or, sometimes, in order to be effective against persons other than the original parties. As stated in Powell on Real Property "such statutes embody the belief that mere possession by a tenant is not sufficient ground for holding a subsequent acquirer of the land's ownership to have 'notice' of a long-term lease."

In order to insure a lessee's interest, the entire lease should be recorded. If a short-form lease is recorded, it must be sufficient in itself to create the entire interest which we insure without having to refer to the unrecorded full lease. Of course, all requirements of the recording law to establish constructive notice from the record must be fulfilled. Reliance should not be placed on possession in the absence of a proper recording.

Please review the Endorsement Manual Section 13 for further discussion of these issues.

Leases

Basic Sale-Leaseback Transactions and Separation of Land from Ownership of Improvements

SPECIAL CARE MUST BE EXERCISED IN INSURING TRANSACTIONS IN WHICH A SALE OF THE PROPERTY IS IMMEDIATELY FOLLOWED BY A LEASING OF THE PROPERTY BACK TO THE ORIGINAL OWNER. THIS IS ESPECIALLY TRUE WHERE THE PARTIES HAVE SEPARATED THE OWNERSHIP OF THE LAND FROM THE OWNERSHIP OF THE BUILDINGS OR IMPROVEMENTS.

The sale-leaseback technique developed by the financial markets is a way of investing in buildings. It offers several advantages to the previous owner who is now the lessee of the property. The lessee can deduct all rent for income tax purposes and not merely interest, as in the case of mortgage financing. Further, the lessee can achieve 100 percent financing, because all the cash is available from the transaction.

Several title insurance questions are presented in dealing with this technique and customers usually make special requests for coverage and pricing. The principal variations of the technique are as follows:

Basic Sale-Leaseback
The owner of the property conveys the land and improvements by deed directly to the investor who, in turn, leases back the property to the original owner for a period of years. The investor will require an owner's title insurance policy and, in some instances, an owner's leasehold form policy will also be requested covering the leasehold interest of the new lessee. Since this is part of one transaction, the owner's policy covering the investor's fee title must be issued with an exception in Schedule B relating to the terms and provisions of the leasehold, such as:

> *Terms and provisions of the lease agreement from ________________ to _____________ dated ________________ and evidenced of record by a (lease or memorandum) recorded on ____________ in Book _____, at Page _____.*

In all cases the lease should be carefully examined to determine whether it contains either an option or an obligation on the part of the lessee to repurchase the property or any other situation creating a danger that a court might construe the transaction as a mortgage. The owner's policy should not be issued without specific authorization of your Company underwriting advisor if any of the following circumstances exist:

a. The purchase price for the property being paid by the investor is clearly much less than the property is worth.

b. The seller/lessee has an obligation to purchase the property (not just an option), whether the obligation is contained in the lease or in a separate instrument. Such obligation is sometimes in the form of an option to the investor to sell back to the seller.

c. The lease contains an option on the part of the lessee to repurchase the property for $1,000 or some other amount far below the amount which the lessor paid or the option price gradually reduces to some token amount.

d. The transaction contemplates that the seller/lessee will build valuable improvements on the land and the term of the lease is 10 years or less – or any term which the examiner considers unreasonably short for amortizing that investment (indicating an economic compulsion on the part of the lessee to buy back the property at the termination of the lease – even if the lease has no specific provisions concerning repurchase).

e. The lease or some other document in the transaction contains language reflecting the fact that the parties intend the transfer of title to be for security only – as for example, references to "the lender" or "this mortgage."

Sale-Leaseback with Mortgage

Vacant land may be conveyed by the owner to the investor by deed and leased back to the original owner. In order to finance construction, the investor also makes a construction loan on the leasehold interest of the lessee, (or gives a takeout commitment to an interim lender). Three different policies may be requested:

A. An owner's policy to the investor insuring its fee title.

B. An owner's policy to the seller-lessee insuring its leasehold.

C. A mortgagee's policy to the investor covering the leasehold mortgage.

Amounts and Billing:

Policy A: Covering the investor's fee title, should be issued for the full amount of the land and improvements existing at the time the policy is to issue. That is, if the investor wants a policy on the vacant land and dated prior to the commencement of construction; the policy may be issued for the value of the land alone. If, on the other hand, the policy is to be dated after construction, it must be for the full value of the land and improvements.

In either case, the policy should have an exception in Schedule B for the terms and provisions of the lease and, if their mortgage is recorded as part of the same transaction, it should have an exception for the mortgage. If the lessor does not join in the mortgage, the exception for the mortgage can be followed by a statement that it affects the leasehold only.

Policy B: Covering the interest of the lessee, should be issued for the amount required by local regulation, statute or practice for ordinary leasehold policies utilizing the ALTA Leasehold endorsement forms. If this policy is issued at the same time as Policy A, any special rates applicable to issuance of owner's and leasehold policies would be applicable. However, a simultaneous issued rate should not be used as there is cumulative liability on the issuance of the policies covering the two estates insured on the same property.

Policy C: Covering the mortgage is, of course, in the amount of the mortgage. If it is issued at the same time as Policy B and in an amount not greater than Policy B and if you are in a state which permits a simultaneous issue rate, this rate can be billed.

If you are asked to issue only Policy A in the full amount of the land and improvements and Policy C, and provided the Insured in each policy is the same party, you can treat these at a simultaneous mortgage issue rate, but only if you add to the bottom of Schedule B of the Owner's Policy the following:

"NOTE: This policy is issued concurrently with Loan Policy No. __________. Any payment made under said

Loan Policy reduces the coverage of this policy by a like amount."

A similar exception should be made to the loan policy, with reference to the owner's policy number.

Again, be sure that the lease has been examined for options and obligations to repurchase as described in paragraph 1 above.

Sale-Leaseback with Severance of Land and Buildings

In some transactions, the owner of improved property will convey the land alone to the investor by a deed which specifically reserves the ownership of the buildings to the original owner. The reservation may be for a specific number of years or may be unlimited.

The investor then leases the land alone back to the original owner using a lease which specifies that at the end of the lease term (or whenever the lease is sooner terminated) the ownership of the buildings and improvements will be in the lessor. Sometimes the lease will specifically give the lessor an option to buy the buildings and improvements. Sometimes the lessor has an obligation to pay for the buildings and improvements at the termination of the lease. Sometimes the lessee is given an option to buy the land.

Frequently, this type of sale-leaseback will be accompanied by the making of a loan by an outside lender secured by a mortgage on the ownership of the buildings and improvements and by the leasehold interest in the land.

All requests to insure separate ownership of the land and improvements should be discussed with your Company underwriting advisor.

Please review the Endorsement Manual Section 13 for further discussion of lease issues.

Leases

Options to Purchase

WHERE A TITLE EXAMINATION DISCLOSES THAT A LEASE CONTAINS AN OPTION FOR THE LESSEE TO PURCHASE THE PROPERTY, CARE MUST BE TAKEN TO BE SURE THAT THE POLICY DOES NOT INADVERTENTLY INSURE THE VALIDITY OR ENFORCEABILITY OF THE OPTION. ALL REQUESTS TO INSURE AN OPTION MUST BE REFERRED TO YOUR COMPANY UNDERWRITING ADVISOR. WHERE PROPERTY WAS AFFECTED BY A LEASE AND WE ARE ASKED TO INSURE THE PROPERTY FREE OF THE LEASE, CONSIDERATION MUST BE GIVEN TO WHETHER THE LEASE CONTAINED AN OPTION TO PURCHASE. IN SITUATIONS IN WHICH THE OWNER OF PROPERTY SELLS THE REAL ESTATE AND IMMEDIATELY TAKES BACK A LEASE ON THE PROPERTY, THE PRESENCE IN THE LEASE OF AN OPTION TO PURCHASE MAY AFFECT THE INSURABILITY OF THE TRANSACTION.

Where the landlord has given the tenant an option to purchase the real estate, the exact legal nature of the option can be a complicated question. If the lease is being insured, special care must be exercised to avoid creating the implication that the option is being insured also. In describing the leasehold interest in the commitment or policy, do **not** use the terms such as "Lease and option created by document number …" or "rights of the lessee under a certain lease agreement between… and…"

If the Company is specifically requested to give insurance concerning the option, this request should be submitted to your Company underwriting advisor.

Please review the Endorsement Manual Section 55 for further discussion of these issues.

When a lease and option have been raised as an exception to an insured title, or where the lease and option have been disclosed in the examination of the title, they should not be waived or ignored on a subsequent commitment or policy simply because the period of the lease or the time during which the option could be exercised has expired. Care must be taken to be sure that the possession of the property is no longer in the lessee or in anyone claiming by, through, or under the lessee and a special effort must be made to determine whether the option was ever exercised.

In a sale-leaseback situation (that is, a situation in which the owner of the property conveys the property and immediately leases it back), the presence of a purchase option in the lease may be evidence that the transaction was intended merely as a mortgage or security device rather than a true sale and lease. This requires special treatment in insuring either the interest of the landlord or the interest of the tenant. (See Sale-Leaseback Transactions and Separation of Ownership of Land from Ownership of Improvements in Section Leases 4).

Leases

ALTA Leasehold Coverages

THE ALTA OWNER'S AND LOAN POLICY FORMS ARE TO BE USED IN ALL CASES WHEN YOU ARE ASKED TO INSURE LEASEHOLD INTERESTS OR LOANS ON LEASEHOLD INTERESTS. ALTA ENDORSEMENT FORM 13-06 AND FORM 13.1-06 MUST BE ADDED TO THE APPROPRIATE 2006 POLICY.

Please review the Endorsement Manual Section 13 for further discussion of these coverages and guidelines for issuance.

Withdrawal of former ALTA policy forms and adoption of the 2006 policy forms

From 1975 to 2001, ALTA approved issuance of policy forms designed for usage when the insurer was asked to insure a leasehold interest or a loan on a leasehold interest. ALTA withdrew its former policy forms accompanied by approval of endorsements designed to expand on the coverages afforded by those policies. ALTA Endorsement Form13-06 is intended for usage with the 2006 Owner's Policy and ALTA Endorsement Form 13.1-06 is intended to be used with the 2006 Loan Policy. If you are in a state that is not using these forms, please consult with your Company Underwriting Advisor.

Improvements

Significantly, the endorsements add coverage for the value of Tenant Leasehold Improvements, which are defined as those, including landscaping, required or permitted to be built on the Land by the Lease and that have been built at the lessee's expense or in which the lessee has an interest greater than the right of possession during the Lease Term. For example, some lessees are granted fee ownership of improvements during the terms of the lease. If the Insured is dispossessed by reason of a covered title matter, the endorsement recognizes loss for that value which is not salvageable. It should be noted that under the endorsement the insured is not required to "own" the improvements whether by severance of the fee estate or otherwise. If an Insured, however, requests that the policy insure the lessee's fee title to the severed improvement, the matter should be discussed with your Company underwriting advisor.

Defined estate, valuation of estate, miscellaneous items of loss

Similarly in effect to the former policy forms, the endorsements include a definition of Insured Leasehold Estate, method of evaluating the estate, and provisions for miscellaneous items of loss. The insured estate continues to be defined as the right of possession for the term of the lease. The Lease Term has been expanded to include any renewal or extended term if a valid option to renew or extend is contained in the lease.

Amounts of insurance in excess of costs of construction of improvements will be based on the provisions of paragraphs 2 and 3 of Form 13-06 and Form 13.1-06. The first of these paragraphs, entitled “Valuation of Estate or Interest Insured”, provides that after the Insured has been evicted, the Insured’s loss or damage shall consist of the value of the remaining portion of the duration of the lease, taking into account rent which is no longer required to be paid. Miscellaneous items of loss include the reasonable cost of removing and relocating any personal property (defined) chattels on the land for the first one hundred miles. The insurer is liable for expenses incurred securing a replacement leasehold equivalent to the insured one.

The insurer is also liable for the fair market value, at the time of eviction, of the interest of the Insured as lessor under any sublease or lease they may have entered into. Damages for breach of such leases or subleases are also covered.

Violation of covenants or restrictions of record

The endorsements provide for recognition of loss an Insured may sustain if it cannot use the premises for the intended purpose, if the lease allowed such a purpose, as a result of a matter covered by the policy. This means that the Insured will have the same measure of damages if it cannot use the Land for the intended purpose as it would have if it were dispossessed. However, it must be remembered that *the impact of zoning ordinances is excluded from the policy, unless a special endorsement (e.g. an ALTA 3.1-06) is approved*.

Unless a zoning endorsement is approved for policy, the provision in the leasehold endorsements relates only to the enforcement of a recorded covenant or restriction prohibiting the intended usage by the Insured.

Loss before substantial completion

The risk of dispossession and loss of unsalvageable improvements before completion of construction is addressed at paragraph 3(g) of Form 13-06 and Form 13.1-06.

Terms of the lease

It is no longer necessary to raise the terms of the lease as a Schedule B exception due to the definition of "eviction" contained in the endorsements. Eviction is defined as the lawful deprivation, in whole or in part, of the right of possession insured by the policy, or prevention of the use of the Land for the purposes permitted by the Lease as a result of a Covered Title Risk. If the tenant is threatened with eviction in accordance with the terms of the Lease, for non-performance of a lessee covenant for instance, that is not a covered matter.

Leases

Synthetic Leases

SPECIAL CARE MUST BE EXERCISED WHEN INSURING A SYNTHETIC LEASE TRANSACTION. RECHARACTERIZATION AND SPECIAL MARKETABILITY EXCEPTIONS SHOULD BE RAISED IN THE POLICY. SPECIAL COVERAGES CONCERNING SYNTHETIC LEASE TRANSACTIONS, WHEN REQUESTED, MAY BE AVAILABLE.

A synthetic lease is a financing vehicle used in real property transactions which combines the off-balance sheet accounting characteristic of an operating lease with the tax attributes of conventional debt financing.

A synthetic lease can be identified by its provisions. An example of a provision which appeared in a recorded memorandum of lease, reads as follows:

> *It is the intent of the parties that: (a) the transaction contemplated hereby constitutes an operating lease from Lessor to Lessee for purposes of Lessee's financial reporting only, (b) the transaction contemplated hereby preserves ownership in the Leased Property in Lessee for Federal, and state income tax, bankruptcy and UCC purposes, (c) this Lease grants a Lien in the Leased Property to Lessor, (d) the obligations of Lessee to pay deemed principal portion and deemed interest portion of Rent shall be treated as payments of principal and interest, respectively. Except as specifically provided for herein or in the Lease, Lessor shall be deemed to have a first prior, perfected security interest in and lien on the Leased Property, free and clear of all liens other than Permitted Liens, as security for the obligations of Lessee under the Operative Documents (it being understood and agreed that lessee does hereby grant a security interest and lien and convey, transfer, assign, mortgage and warrant to Lessor and its successors and assigns, all rights, title and interest of Lessee in the Leased property and any proceeds of products thereof, to have and hold the same as security for the payment and performance of the obligations of Lessee under the Operative Document).*

There may also be included in the synthetic lease many of the same provisions included in any mortgage or deed of trust, such as foreclosure provisions, power of sale, future advances, etc.

There are various structures being utilized in synthetic lease transactions. The basic form is the simple two party sale-leaseback transaction. In larger deals, structures using a special purpose entity (SPE) are developed for participation.

The entity formed might be a special purpose corporation formed by the financial investor or bank. The SPE issues notes and enters into a sale-leaseback with seller/lessee. The rent payments under the lease are equal in amount to the principal and interest payments on the notes. In most cases, the rent payment is equal to interest only, and the principal satisfied when the lessee exercises its option and repurchases the property.

In another variation, a single purpose owner trust is created. The owner trust is a passive entity which acts as lessor, holds title to the property and leases it back. In order to meet accounting guidelines, the trust is capitalized with a nominal 3 percent equity investment. The owner trust issues notes which are secured by a mortgage.

What Policies to Issue?

The owner/lessor would most likely be requesting the issuance of an owner's policy. The policy should contain a recharacterization exception as follows:

> *Any assertion or determination that (a) the lease referred to at exception number ____ ("Lease") is not a "true lease" or (b) the vesting of title in the insured by deed ("Deed") is part of a loan transaction, including an assertion that the Deed together with the Lease constitutes a mortgage or other security device (a "Mortgage").*

Customers have recognized the appropriateness of this exception. However, in the event the transaction is determined to be a security device, they wish us to affirmatively insure the lien of the mortgage.

It may be possible to do this if there is granting language sufficient to create a valid mortgage in the lease under the laws of a given jurisdiction, and the language creating the mortgage is adequate to give third parties notice of the lien. In other words, having an insurable mortgage created within the lease. Examples of granting language we have insured:

> *1. Lessee does hereby mortgage, pledge, grant, bargain, sell, convey, assign, warrant, transfer and set over to (lessor) with power of sale . . . all of the Lessee's right, title and interest, if any, in the land demised.*
>
> *2. Lessee hereby grants to Lessor . . . a first and paramount lien on the leased property. . . . Lessor shall have all the rights,*

powers and remedies of a mortgagee and secured party available under applicable law following a default or an event of default to take possession of and sell the Land (whether by foreclosure, power of sale or otherwise).

3. Lessee hereby grants . . . mortgages, and hypothecates all of lessee's right, title and interest . . . (to the extent necessary to effect provision that if the court determines that the lease is treated as a financing transaction, parties intend that the lease be a mortgage). . . . The effective date of such mortgage shall be the effective date of this lease.

If this is done, the following affirmative language can be added to the exception where jurisdictionally allowable:

Provided, however, that in the event of a final determination by a court of competent jurisdiction that such Deed and/or Lease creates a mortgage or other security device from the Lessee in favor of the Lessor under the Lease, the Insured hereunder shall hold all the rights of an Insured under an ALTA Loan Policy [add the appropriate ALTA reference] insuring the Mortgage as a Lien against the subject property as of the effective date with an insured amount of $ (same as loan amount) subject to no other exceptions other than those set forth herein, after the Insured has agreed to surrender all of its rights under this Owner's Policy.

Because of the nature of the transaction, an exception for unmarketability should be raised as follows:

This policy does not insure against loss or damage and the Company will not pay costs, attorneys' fees or expenses which arise by reason of a claim that the title to the land is unmarketable by reason of any provision in the documents to the transaction creating the interest of the insured.

The lessee may also be looking for a leasehold owner's policy. Since the lease being insured provides that it is the intention of the parties that it be considered a security device, a recharacterization exception should be shown in Schedule B.

Again, it may be possible to insure the lessee that if a court of competent jurisdiction holds that its leasehold is a security device, the lessee will be determined to be the owner, subject to the mortgage or security device. Appropriate affirmative language is as follows:

Provided, however, in the event of a final determination by a court of competent jurisdiction that such Deed and/or Lease create a mortgage from the Lessee in favor of the Lessor under the Lease, and Lessee is the fee simple owner of the subject property, the Lessee shall have all of the rights of an insured under an ALTA Owner's Policy [add the appropriate ALTA reference] insuring the Lessee as the fee simple owner of the subject property as of the effective date with an insured amount of $ (same as tenant's policy) subject to no exception other than those set forth in Schedule B hereof.

Once again an unmarketability exception should be shown.

In addition to the above, a third party lender may be seeking a loan policy. If the sale-leaseback transaction is a security device, and the owner/lessor is attempting to make a mortgage, you would have a mortgage on a mortgage. The leasehold estate would be created prior to the mortgage. You should, therefore, raise an exception for recharacterization.

To eliminate this exception from any mortgage policy insuring the third party lender, it would be necessary for the original owner/lessee to subject its fee/lessee interest to the third party lender mortgage. This third party mortgage is sometimes a construction loan. If you get such a mortgage, contact your Company underwriting advisor.

Limited Liability Companies and Limited Liability Partnerships

YOU MUST ALWAYS CHECK THE PARTICULAR REQUIREMENTS AND LIMITATIONS OF THE STATE LAW FOR THE STATE IN WHICH THE LIMITED LIABILITY COMPANY OR LIMITED LIABILITY PARTNERSHIP HAS BEEN CREATED AND THE STATE IN WHICH THE REAL PROPERTY IS LOCATED.

Limited Liability Companies

A popular vehicle for business organizations is the limited liability company (LLC). It combines the limitations on personal liability enjoyed by corporations with the flexibility previously the bailiwick of smaller organizations. No member of the company has personal liability, which makes it much more attractive to a party who would have had such liability in his or her capacity as a general partner of either a general or limited partnership.

Our difficulty in dealing with these entities in terms of title insurance is that they are not uniform across the country. They are a creation of state statute, and each state has created its own requirements. It is, therefore, impossible to speak in generalities about what underwriting requirements need to be met to correctly deal with an LLC in a transaction. You must always check the particular requirements and limitations of the state law for the state in which the LLC has been created and the state in which the real property is located. You must make sure a foreign LLC is recognized and authorized to do business and/or hold title to real property, in your state. You must check that any suggested “conversion”, “merger” or “consolidation” of LLCs or combinations of LLCs and other business organizations is authorized. You must make no assumptions about how an LLC is created, operated, or is dissolved.

The following is a discussion of the specifics to consider when examining the state law and the documentation creating the LLC you are dealing with.

Creation

How is the entity created? What steps must be followed to bring this entity into being? Must the words "Limited Liability Company" or the abbreviation "LLC" or "L.L.C." be part of the name? Many states provide for the filing of some type of certificate or other document, usually with the Secretary of State. Verify the where and the how of creation.

Structure

The documentation on which the entity is based is often called an "operating agreement". The parties involved in the entity are usually called "members". How are new members admitted? Are there different classes of members? The one or more parties that operate the entity are commonly referred to as "managing" or "operating" members. A manager may not have to be a member. What is the relationship of the member or manager to the entity, e.g. can a member or manager lend money to the entity and still be treated as any other creditor would be? There may be a provision for a minimum number of members. There may also be a provision for "series of members." These are like subsidiaries in that the particular group (or series of members) operates separately, and the assets of the group are all that are available to the creditors of the group.

Modification

What are the statutory requirements for the assignment or sale of a member's interest? How is the agreement corrected, amended or modified? Are there special requirements to be met for the modification, correction or amendment of specific provisions? Are there any additional filing requirements after modification, correction or amendment?

Merger

Do these entities have the ability to merge under state law? Can they merge with foreign entities? Can they merge with other domestic non-LLC entities? If so, how is this accomplished? What type of documentation and authorization should we ask to review? Most importantly, what is the effect of a merger on the ownership of real property assets?

Dissolution

What triggers dissolution? Are there provisions for involuntary dissolution? What powers do the manager/members have during the winding down period? How is distribution of the assets accomplished after dissolution? Who or what is title vested in during and after dissolution?

Limited Liability Partnerships

Another newer type of business organization, although not nearly so widespread, is the Limited Liability Partnership (LLP). The statutes creating these entities can be found in various places, such as the LLC statutes or the Partnership statutes or specific LLP statute sections. As with the LLC, there is no uniformity between the states that do recognize these organizations. Again, you will need to check the state law and the documentation creating these entities to determine if the parties to your transaction are in conformity and that all proper authority issues have been adequately dealt with. The matters discussed previously in relation to LLCs would be a good place to start.

Red Flags

You should consider and follow all current guidelines published by the Company on this topic concerning the authority of parties to bind the LLC or LLP.

When a transaction involves a conveyance or a financing by an LLC or LLP, all authority documents must be reviewed.

If the following RED FLAGS appear as part of your transaction, you must seek approval of Company underwriting advisor.

- A recent change in the state filings of the LLC or LLP that adds or deletes parties with authority or a change in the LLC or LLP agreement that attempts to do the same.
- Any transaction that involves conveyancing or mortgaging of Land by or to a partner of the LLP or a member of the LLC must be approved by your Company underwriting advisor.
- Foreign Executions - When Directors or other entity officials are not located in the United States or the corporate documents reveal the owners are not located in the United States, their signatures are to be acknowledged pursuant to our foreign notarial guidelines, including compliance with the terms of the Hague Convention, if applicable.
- Any recent amendment to the LLC or LLP agreement, adding or deleting parties to the entity.

- Any variation in name, no matter how minor, in chain of title or the documentation submitted to support the chain of title.

- Any recent conveyance without corresponding financing.

Verification of Signatures
There are a number of actions you might take to verify you have the proper parties executing the instruments. If the entity has counsel, you might require that counsel to verify the signatures. If there is a key signature or a number of random signatures that you want to verify, obtain the phone number or email address of the signatories from a source other than the party that you are dealing with, and contact those signatories.

Marketable Title Coverage

WHENEVER YOU DELETE OR GIVE AFFIRMATIVE COVERAGE OVER AN EXCEPTION, YOU SHOULD PAUSE AND CONSIDER IF THE MARKETABLE TITLE COVERAGE OF THE POLICY CREATES A RISK THAT YOU MUST ADDRESS AS WELL.

Since the 1970 ALTA policies, Unmarketable Title coverage (or “unmarketability of title” coverage) has been one of the four “title” coverages found in both owner’s and loan policies. The current policies insure against loss or damage as a result of “Unmarketable Title” in Covered Risk 3. Unmarketable Title is defined in Condition 1(m) of the ALTA Loan Policy and Condition 1(k) of the ALTA Owners Policy as:

> *"Unmarketable Title”: Title affected by an alleged or apparent matter that would permit a prospective purchaser or lessee of the Title or lender on the Title or a prospective purchaser of the Insured Mortgage to be released from the obligation to purchase, lease or lend if there is a contractual condition requiring the delivery of marketable title.*

The concept of Unmarketable Title arose to allow a court of equity to excuse a purchaser from performing a contractual obligation to purchase land if the title being offered is potentially defective or encumbered by a matter not accepted by the buyer in the purchase contract. A court might excuse the buyer even if the prospects of a successful attack on the title are remote. As a result, ownership of an estate or interest in land in the United States carries a risk that an agreement to sell, lease or mortgage the land might be avoided if the prospective buyer, tenant or lender discovers a defect, lien or encumbrance not on its approved list. If the owner’s policy doesn’t include an exception for that defect or encumbrance, the title insurer may be liable indemnify its holder for the loss under Covered Risk 3.

An Unmarketable Title issue can arise in four basic circumstances. First, it may arise in a case where the title searcher has either missed a defect or encumbrance, or production drops the exception in the commitment or policy. Generally, the policy accepts the unmodified Marketable Title risk for these circumstances. Since there will be no exception, there will be no affirmative coverage over that matter either, unless it is in a general endorsement like an ALTA 9-06.

Second, there may be a defect, lien or encumbrance found by the searcher that may or may not affect the Title. For example, the title might include an old, unlocated easement on a larger source tract.

Third, we may uncover a defect, lien or encumbrance that affects the parcel, but is now unenforceable. For example, the title might include a set of old restrictions that have no relevance to the recent use of the land.

In the second and third situations we may decide to accept the risk of a loss from enforcement defect, lien or encumbrance, but not from Unmarketable Title, because the apparent matter invites an unscrupulous policyholder to enter into an inflated contract to sell with a confederate who then escapes the obligation to purchase because the matter makes the title unmarketable.

We can address this risk in two ways; with an exception for marketability only or with a modification of the definition of Marketable Title for that specific exception. The exception for marketable title only may leave the company liable if someone attempts to enforce the defect, lien or encumbrance, but it excepts to any liability for marketable title. Modifying the definition of marketable title gives the policyholder limited marketable title coverage, as well:

EXCEPTION FOR MARKETABILITY ONLY

> *Unmarketable Title as a result of [covenants, conditions and restrictions dated March 21, 1923 and recorded in Book ______ Page ______].*

EXCEPTION, AFFIRMATIVE COVERAGE AND MODIFIED DEFINITION OF MARKETABLE TITLE

> *[Covenants, conditions and restrictions dated March 21, 1923 and recorded in Book ___________ Page ______]; however this policy insures against loss or damage, including Marketable Title, as a result of the enforcement of [these covenants, conditions and restrictions]; provided that the offer of this or any other reputable title insurance company to give the same insurance against [these covenants, conditions and restrictions] at its regular*

premium rates shall be conclusive evidence of Marketable Title as it applies to this exception.

Please review the Endorsement Manual Section 34 for discussion of the ALTA Identified Risk Coverage endorsement (34-06) for further examples of coverage limitations.

That fourth scenario? We take exception to a matter that affects the Title. We are unwilling to give the policyholder any affirmative coverage because the matter is enforceable. The unqualified exception protects the title insurer against liability for indemnity and Marketable Title. That's a good place to leave it.

Some states have marketable title acts or title standards. We may apply a state marketable title standard in our analysis of a Marketable Title risk, but meeting the state criteria is not necessarily dispositive for our underwriting decision. If a state marketable title standard disallows any encumbrance on the title that has not been created or renewed with the last sixty years, we could take comfort that the CC&Rs created in 1923 in our illustration should have lapsed under the act, making a decision to insure over them easier.

Finally, Marketable Title is not the same thing as marketable land. If a potential purchaser, lessee or lender refuses to close as a result of some physical defect in the land, for example, the discovery of hazardous wastes stored on the land, the loss of value is not a matter insured against by a title insurance policy. There are many factors that can affect the price or even the acceptability of land on the market that don't affect the title. A decision whether to take exception to a non-title matter is usually easy, it should not be necessary. However, if you have notice of some matter that can affect the price of the land, and you are unsure whether to take an exception, you should consult your Company underwriting advisor.

Mortgage Electronic Registration Systems, Inc. (MERS)

MORTGAGE ELECTRONIC REGISTRATION SYSTEMS, INC. ("MERS") HAS BEEN IN EXISTENCE SINCE THE LATE 1990'S AS A CLEARINGHOUSE FOR THE SECURITIZED LENDING BUSINESS. DISCUSSED BELOW ARE SOME ISSUES WHICH MAY ARISE WHEN INSURING MORTGAGES AND DEEDS OF TRUST ("DOT") THAT HAVE BEEN REGISTERED WITH MERS.

Named Insured
You are reminded that Company policy prohibits naming MERS as the **sole** Insured in any loan policy. The following forms are the only approved ways to name the Insured on Schedule A when the mortgage is held of record by MERS as nominee, either by specific assignment, declaration, or otherwise in the Insured Mortgage. You are authorized to use only the following formats to reflect the Insured in the Loan Policy. There should be no variations.

1. *[Name of Lender], its successors and assigns,* or

2. *[Name of Lender], its successors and assigns appearing of record as Mortgage Electronic Registration Systems, Inc., as nominee,* or

3. *[Name of Lender] and Mortgage Electronic Registration Systems, Inc., solely as nominee for the Lender, its successors and assigns, as their interests may appear.*

This has been the Company position since MERS was chartered in 1997, and is in compliance with Freddie Mac and Fannie Mae directions to their servicers.

Foreclosure of MERS related lien
FANNIE MAE in its Servicing Guide directs that MERS must NOT to be named as a plaintiff in any foreclosure action whether judicial or non-judicial, on a mortgage loan owned or securitized by Fannie Mae. It directs that the loan servicer is to obtain an assignment from MERS to itself or Fannie Mae, if

Fannie Mae requires the foreclosure to be brought in the name of Fannie Mae. The assignment must be recorded before the foreclosure begins.

FREDDIE MAC provides that effective for mortgages registered with MERS that are referred to foreclosure on or after April 1, 2011, Servicers must prepare an assignment of the Security Instrument from MERS to the Servicer and instruct the foreclosure counsel or trustee to foreclose in the Servicer's name and take title in Freddie Mac's name.

It must be verified that the use of MERS as the foreclosing party is in compliance with all aspects of state law.

Foreclosure where MERS, as nominee, is Junior Lien Holder

If your statutes require notice to or service on all junior lien holders, and if a MERS mortgage appears of record as a lien that is junior to the mortgage being foreclosed, you need to consider the following issues when preparing foreclosure commitments, binders or other foreclosure products and searches, or examining foreclosure proceedings in your jurisdiction:

1. If MERS is a necessary party it should be shown in the following manner, as a proper or necessary party (if required by your foreclosure commitment form) by virtue of holding the record interest in the mortgage/DOT:

> *MERS as nominee, of _______________, the record mortgagee/ beneficiary in the mortgage/DOT recorded as document ______and shown at Exception___.*

2. If the current holder of the note secured by the MERS mortgage / DOT is a necessary party it should be shown in the following manner:

> *The current owner and holder of the indebtedness secured by the mortgage /DOT recorded as document _______ and shown at Exception _________, by name [if your statutes allow other options you should add here]*

3. An informational note, such as the following, may be added to show who apparently held the note at the date of recording of the MERS mortgage, and to direct the customer to MERS for additional information:

> *NOTE: On _____, the date of recording of the above-noted mortgage, it appeared that_____ [lender named on*

the MERS mortgage] was the owner and holder of the indebtedness secured by said mortgage. It is possible to obtain information as to the current owner and holder of the indebtedness, and/or the servicer or the indebtedness by contacting MERS at 888-679-6377 or through the MERS website.

Mineral Interests

Severed Mineral Interests

ANY OUTSTANDING MINERAL INTEREST MUST BE EXCEPTED FROM A POLICY WHEN THAT POLICY IS BEING ISSUED ON AN ESTATE OR INTEREST WHICH OTHERWISE WOULD INCLUDE SUCH MINERAL INTEREST. ENDORSEMENTS WHICH LIMIT THE EFFECT OF THE EXCEPTION, OR WHICH INTERPRET THE EXCEPTION, CAN ONLY BE ISSUED WITH THE APPROVAL OF YOUR COMPANY UNDERWRITING ADVISOR. A POLICY WHICH INSURES THE OWNERSHIP OF A MINERAL ESTATE OR INTEREST, OR THE VALIDITY OR PRIORITY OF A LIEN THEREON, MAY ONLY BE ISSUED WITH THE APPROVAL OF YOUR COMPANY UNDERWRITING ADVISOR.

When the chain of title discloses any outstanding mineral interest, it must be shown as an exception from the coverage of the policy when the policy insures an estate or interest which would otherwise include such mineral interest.

An outstanding mineral interest is any right possessed or claimed by a person other than the owner of the estate or interest being insured in the policy, to remove any part of the dirt, soil, rock, surface or subsurface minerals, either with or without a right to enter upon the surface of the Land for the purpose of such removal, or to receive a part of any of the same when removed, or the purchase price of any of the same when removed, regardless of whether such right might be classified as a fee ownership, a leasehold estate, an easement or license to remove, a royalty interest, or any similar classification.

Minerals intended to be included in the outstanding mineral interest might consist of coal, oil, gas, clay, lead, zinc, limestone, sand, gravel or other commercial substance, gold, silver, diamonds and other precious metal or stones.

The full fee ownership of land includes all minerals. The severance of a mineral interest from the remainder of the ownership is usually accomplished by 1. a reservation from a conveyance of the remainder of the ownership, whether that conveyance be federal or state patent or a private deed of conveyance, 2. by a deed of express grant, or 3. by a lease giving the right to explore and remove.

Mineral Interests

Form of Exception

OUTSTANDING MINERAL INTERESTS IN THE CHAIN OF TITLE MUST BE EXCEPTED FROM THE LEGAL DESCRIPTION IN SCHEDULE A AND BE SHOWN AS A SPECIAL EXCEPTION IN SCHEDULE B.

The mineral interest excepted must be described in the same way it appears in the instrument that creates or reserves it.

An express or implied easement for a right of entry through or over the surface must be added to the exception in the legal description in Schedule A or be shown as a special exception in Schedule B.

You should not show subsequent transfers of or encumbrances on the excepted mineral interests. The policy should clearly state that subsequent transactions have not been considered.

Where the mineral interest is one which has been totally severed from the balance of the fee simple estate or interest therein, the exception must be noted in the legal description in Schedule A.

An example of this form of exception and the express or implied easement exception is as follows:

> *…except the coal, oil, gas and other minerals underlying the surface of said land and all rights and easements in favor of the estate of said coal, oil, gas and other minerals.*

In addition to the above exception added to Schedule A, a special exception must be added to Schedule B in the form shown below. The reference to the minerals must incorporate the identification of the particular mineral granted or reserved. An example follows:

> *Reservation (Grant) of (an undivided _______________ interest in) the coal, oil, gas and other minerals underlying said land contained in the____ dated _________ and recorded ___________ as Document No.___________ and all rights and easements*

thereunder by said holder of the coal, oil, gas and mineral estate or by any party claiming by, through or under said holder.

The mineral interest and any easements included must be shown in the same manner as the instrument granting or reserving it. To change the language may constitute an interpretation or limitation of the effect of the exception. For example, “coal and other minerals” may not be the same as “coal, oil, gas and other minerals, or “coal and other minerals mixed with coal.”

When a mineral interest is excepted in its entirety, we do not follow the chain of the mineral estate excepted unless specifically requested to do so. You must advise the customer by adding the following note to the Schedule B exception shown immediately above:

NOTE: Mineral title not shown further.

Where only an undivided portion of a mineral interest has been reserved or granted, you must search and examine the entire interest.

The instructions stated above for showing express or implied easements for a right of entry over or through the surface as part of an exception to the legal description shown in Schedule A constitutes a permitted deviation from guidelines set forth elsewhere. Even though such easements may not affect the fee title described in Schedule A, the critical relationship between the easement and the mineral estate requires that these easements be shown as exceptions to the legal description in Schedule A, as indicated above.

Mineral Interests

Termination of Mineral Estates

A MINERAL ESTATE IS NOT TERMINATED AS A SEPARATE ESTATE UNLESS THERE IS MERGER WITH ANOTHER PERMANENT ESTATE SUCH AS THE FEE TO THE SURFACE. YOU ARE NOT TO RELY ON CLAIMS OF ABANDONMENT, ADVERSE POSSESSION OR THE TITLE THROUGH TAX SALE UNLESS AUTHORIZED BY YOUR COMPANY UNDERWRITING ADVISOR.

A mineral estate, as distinguished from a mineral interest, the distinction being, for example, the difference between an outright conveyance of the coal and a lease of it, is a permanent interest in the land. Such an estate is not generally susceptible to abandonment or adverse possession in the same sense that a surface estate is. Even where only a particular vein or seam of coal is conveyed, and it has allegedly been "mined out," the mineral estate created by that deed cannot be considered to have ended. Present and past mining practices have called for miners to remove only a percentage (usually 50 percent) of the coal leaving the rest for support. At some future time, the recovery of some part of the remainder may become practical.

You are not to rely upon any statutes providing for an automatic termination or reversion of title to a mineral estate based upon the passage of time or other condition unless authorized by your Company underwriting advisor.

Where the mineral estate has not been assessed and taxed separately from the surface, you are not to rely upon titles arising through the foreclosure and sale proceedings for the surface. The estate may be subject to back taxes, however. Where the mineral estate has been separately assessed and taxed and is sold pursuant to foreclosure for nonpayment of those taxes, you are not to rely upon such tax title unless authorized by your Company underwriting advisor. The necessary parties for a valid proceeding may be quite complex.

Mineral Interests

Termination of Mineral Interests

A MINERAL INTEREST OTHER THAN ONE WHICH IS AN ESTATE IN THE LAND HAS A DURATION DETERMINED BY THE PROVISIONS OF THE INSTRUMENT CREATING IT OR BY STATE LAW. THESE PROVISIONS CAN VARY GREATLY, BUT IN GENERAL, EACH MINING INDUSTRY HAS DEVELOPED A DEGREE OF UNIFORMITY. THERE ARE USUALLY THREE ELEMENTS RELATING TO TERMINATION: PAYMENT OF RENT, PRODUCTION, AND TIME. WHERE A STATUTORY PROCEDURE EXISTS FOR DETERMINING THE FACTS RELATING TO THESE ELEMENTS, YOU MUST REQUIRE STRICT COMPLIANCE. WHERE AFFIDAVITS OR INDEMNITIES ARE OFFERED TO ESTABLISH THESE FACTS, YOU MUST REFER THE MATTER TO YOUR COMPANY UNDERWRITING ADVISOR FOR APPROVAL.

IN ADDITION TO THE TERM OF THE INTEREST, OTHER MATTERS MUST BE CONSIDERED. THESE INCLUDE ROYALTIES, POOLING AGREEMENTS, SECONDARY AND TERTIARY RECOVERY, AND EASEMENTS. IN SITUATIONS WHERE THESE MATTERS ARE ENCOUNTERED, THE QUESTION OF TERMINATION MUST BE REFERRED TO YOUR COMPANY UNDERWRITING ADVISER FOR APPROVAL.

The elements of rent and production are often difficult to establish. They may also vary depending on the mineral involved. An oil and gas well will be very different from the treatment of coal.

Rent may be in the form of a minimal payment to preserve the rights which is similar to an option prior to actual production. Rental payments are usually limited to a relatively short term, but not always so. It may also be in the form of a royalty or other payment keyed to production. Payment for easements, be they surface or subsurface, may also be classified as rent. It may also be a credit against future royalty payments.

Production is usually thought of as the removal or mining of the mineral but it may also include the situation where, in the case of oil or gas, although a well is capped, the pumping equipment remains on site and rent is paid usually as a "shut in” payment.

Time may be expressed in definite, easily ascertainable terms, as so many years or days, but it may also be expressed in such terms as “so long as produced.” Legal production may continue even when actual production is delayed or temporarily halted. Pooling is another factor to be considered regarding production.

Rent, production, and time may therefore be exceedingly difficult to establish factually unless a statutory definition or formula is available. Consequently, our reliance on the termination of these interests requires the approval of your Company underwriting adviser.

Royalties are often fractionalized and made the subject of assignments, options, mortgages and pledges. Pooling agreements, which are common in oil and gas production, can be voluntary or involuntary where provided for by statute. Pooling is the combination of well rights for one parcel of land with one or more other parcels.

Easements can be those of the surface for power lines, pipelines, roads, rail tracks, deposit of waste, ventilation, etc. They can also affect the subsurface as where shafts in “mined out” areas are used for ingress to egress from and removal of minerals located on other land. Again, these matters may be difficult to ascertain and can be quite complex so that where they are present, our reliance on termination must be referred to your Company underwriting adviser for approval.

Certain governmental functions must also be considered in relation to the matter of termination. This could include reversion to the government or it could include the right of the government to enter the land to back fill to preclude subsidence, for example. Again, the matter must be referred to your Company underwriting advisor.

Mineral Interests

Insuring Over Mineral Interests

DO NOT GIVE AFFIRMATIVE INSURANCE, EITHER BY ENDORSEMENT OR BY A STATEMENT IN THE POLICY, WHICH MODIFIES OR INTERPRETS THE EFFECT OF A MINERAL INTEREST, WITHOUT THE PRIOR APPROVAL OF YOUR COMPANY UNDERWRITING ADVISOR.

Please review the Endorsement Manual Sections 9 and 35 for further discussion of limited mineral rights coverage for residential loan policies

Although an outstanding mineral interest must be excepted from coverage of the policy, requests are sometimes made for affirmative insurance which modifies the effect or defines the exception.

You are not authorized to give such affirmative insurance without prior approval of your Company underwriting advisor. Customers making such a request should not be encouraged to expect that the submission is any assurance that the request will be granted. The customer should be advised when the request is made that should it be granted, an additional charge will be made if state law permits. You should not give any estimate of the charge as it will be determined by your Company underwriting advisor.

Examples of affirmative insurance sometimes given are:

1. That the surface of the land will not be used for entry to prospect for or remove the minerals included in the mineral interest.

2. That the mineral interest does not include a right to a specific mineral.

An example of affirmative insurance which **must not be given** would be coverage against loss arising from subsidence, i.e., an underground collapse of support of the surface and or the improvements located thereon.

Mineral Interests

Insuring Mineral Estates or Interests

DO NOT ISSUE A POLICY WHICH INSURES THE OWNERSHIP OF, OR THE VALIDITY AND PRIORITY, OR EITHER OF THEM, OF A MORTGAGE OR OTHER ENCUMBRANCE ON A MINERAL ESTATE WITHOUT THE PRIOR APPROVAL OF YOUR COMPANY UNDERWRITING ADVISOR.

If you are requested to issue either an owner's policy or a loan policy on a mineral interest, you must submit the request to your Company underwriting advisor. It may be permissible to adapt the policy forms to insure such estates or interests in some jurisdictions. It may not be possible or desirable under the insurance laws and regulations of other states.

Please review the Endorsement Manual Sections 9 and 35 for further discussion of limited residential mineral coverage.

A problem as to the amount of policy frequently arises. Special examining techniques and policy provisions are always necessary.

In submitting the request, the customer should not be led to believe that the insurance will be issued. You should inform the customer that our regular title insurance charges may not be applicable to policies on mineral interests, and that the charge for the insurance will be quoted by your Company underwriting advisor if it appears that the insurance may be issued.

The following are examples of the interests which might be the subject of insurance, either owners or mortgage:

1. A mineral estate where at least a part of the minerals included within the estate has not been physically severed from the land.

2. A leasehold estate which gives the right to explore for, and to remove, certain kinds of minerals for a prescribed period.

Partnerships

Title to Partnership Property

WHEN A PARTNERSHIP IS INVOLVED IN THE CREATION OR CONVEYANCE OF AN INTEREST IN REAL PROPERTY, SPECIAL TITLE PROBLEMS SHOULD BE CONSIDERED. PARTNERSHIPS ARE GENERALLY CONTROLLED BY STATE ENACTMENTS OF THE UNIFORM PARTNERSHIP ACT AND THE UNIFORM LIMITED PARTNERSHIP ACT, BUT OFTEN WITH VARIATIONS WHICH YOU SHOULD ALWAYS CONSIDER. FOR CONVENIENCE, THE UNIFORM PARTNERSHIP ACT (1914) AND UNIFORM PARTNERSHIP ACT (1997) WILL BE REFERRED TO COLLECTIVELY AS THE ***UPA****. SIGNIFICANT DIFFERENCES WILL BE NOTED. THE TITLE TO REAL PROPERTY MAY BE ACQUIRED BY A PARTNERSHIP IN A NUMBER OF DIFFERENT STYLES. SEARCH THE RECORDS AS TO EACH GENERAL PARTNER INDIVIDUALLY FOR JUDGMENTS, WHICH MIGHT TURN OUT TO BE BASED UPON A PARTNERSHIP DEBT. ALWAYS TAKE AN EXCEPTION AS TO THE TERMS OF THE PARTNERSHIP AGREEMENT IN SCHEDULE B.*

General

A partnership is “an association of two or more persons to carry on, as co-owners, a business for profit (UPA)”. If the facts of a particular transaction do not fit this definition, there may not be a partnership and other law must be considered.

If the parties claiming the existence of a partnership formed their relationship by contract in another state or country, you should look to the law of such other jurisdiction to determine the nature of the association. The best evidence to establish the existence of a partnership is the agreement or contract between the parties.

Ordinarily a partnership organized elsewhere does not need to qualify to do business under the laws of another state; however, state law may vary on this subject and you should review local law on the subject. If you are dealing with a limited partnership formed elsewhere, it is particularly important to review your own state law to see what restrictions, if any, may be imposed on the ability to do business or deal with real property. If the partnership has been formed in another country, consult with your Company underwriting advisor before acting.

Acquisition as Partnership Property

Under the UPA, all property brought into the partnership at its inception or subsequently acquired by purchase or otherwise on account of the partnership is partnership property. Unless the contrary intention appears, property acquired with partnership funds is partnership property. Consequently, it is possible that the title to the partnership property may be acquired in a variety of styles (e.g., in the full names of one or more of the partners; in the name of one partner as part of a firm name, such as John T. Murphy and Company; or in the surname of one or more partners in a firm name, such as Murphy, Callahan, Kelley and Company), and yet in each case be partnership property.

UPA provides that any estate in real property may be acquired in the partnership name. There is no requirement that the firm name reflect the existence of a partnership either for a general partnership or a limited partnership. (See UPA and Uniform Limited Partnership Act, Section IV, infra.).The Uniform Partnership Act (1914) has been adopted in 41 states and the Uniform Partnership Act (1997) enacted in 37 and the District of Columbia, 11 of which enactments were with some degree of overlap because of delayed repeal of the earlier act or failure of repeal. Only Louisiana has adopted neither the UPA (1914) nor UPA (1997)).

The Uniform Limited Partnership Act provides for the filing of a certificate in the records (Recorder's Office) of the county where it is formed giving the partnership name and other data. Other state statutes may require a trade name affidavit to be filed or recorded for a partnership using a name other than that of the surnames of the partners. The recording of the affidavit may constitute prima facie evidence of the facts recited insofar as they affect title to real property.

Schedule B Exceptions

You should always take an exception in the policy to the terms of the partnership agreement when we know we are insuring partnership property. Obviously we may not know that partnership property has been acquired in some cases. However, if you can determine from the record that partnership property is involved or if you have actual knowledge of these facts from other sources, the exception should be shown.

Such an exception might be shown in several ways depending on the knowledge which we have. Two samples follow when the record title discloses the partnership:

> *Terms of the partnership agreement of John Meyer and Phillip Crouse doing business as M. and C. Enterprises.*
>
> *Terms of the partnership agreement of M. and C. Enterprises.*

If the title was acquired by one or more partners without record reference to the partnership, but you have reason to believe partnership property is involved, the following might be shown in Schedule B:

> *Rights in the land of Chicago Marketing Company and its partners, and the terms of the Chicago Marketing Company partnership agreement.*

Joint Ventures

Some entities characterize themselves and accept delivery of title in the style of a joint venture. Generally, such an entity may be deemed a partnership under the UPA. If the entity conforms to the partnership law of your state, you may treat them accordingly. Joint ventures, as a rule, have a more limited purpose and duration than partnerships. For that reason, you should require all joint venturers to join in insured acts, such as conveying, mortgaging or leasing.

Partnerships

Signatory Authority-Conveyancing and Mortgaging

PARTNERSHIP PROPERTY SHOULD BE CONVEYED OR MORTGAGED IN THE SAME NAME OR STYLE IN WHICH THE TITLE WAS ACQUIRED. THE QUESTION OF REQUIRED SIGNATORIES IS DEPENDENT UPON STATE LAW. YOU MUST ALSO CONSIDER THE AUTHORITY OF THE SIGNING PARTNER OR PARTNERS TO ACT. A PARTNER MUST BE SPECIFICALLY AUTHORIZED AS AGENT OF THE PARTNERSHIP TO CONVEY PARTNERSHIP PROPERTY OTHER THAN IN THE ORDINARY COURSE OF BUSINESS. UNLESS AUTHORIZED BY ALL THE PARTNERS, ONE OR MORE BUT LESS THAN ALL OF THE PARTNERS HAVE NO AUTHORITY TO CONVEY THE PROPERTY IN TRUST FOR CREDITORS OR DO ANY OTHER ACT WHICH WOULD MAKE IT IMPOSSIBLE TO CARRY ON THE ORDINARY BUSINESS OF THE PARTNERSHIP.

Partnership property should be conveyed or mortgaged in the same style or manner in which title was acquired. However, the signatures which may be required will be controlled by state law or practice and by the terms of the partnership agreement.

When the title to partnership property has been taken in the name of one or more of the partners, you should consider whether state law requires the signature of the spouse also. If it is difficult to determine that the property is indeed “partnership property,” it may be prudent to have the spouses join in the execution in those states where that is a normal requirement for non-partnership property.

Under the Uniform Partnership Act (“UPA”), when less than all of the existing partners execute a conveyance of partnership property, you must determine the authority of the partner or partners to act on behalf of the partnership.

The Act makes each partner the agent of the partnership for the purpose of its <u>ordinary</u> business. Consequently, a conveyance of title (including leasing and mortgaging) to property in the ordinary course of business may be presumed to be within the apparent authority of the partner. If you have knowledge that the partner has no authority to act as an agent (e.g., from a reading of the partnership agreement), then specific authority from the other partners must be secured. If you cannot easily determine that the conveyance is made in the ordinary course of business, you must establish the authority of the partner to execute the conveyance. Carefully consider the terms of the partnership agreement. A statement of authority signed by all the partners is, of course, the best. A transfer of substantially all of the assets of a partnership is never to be considered in the ordinary course of business, and requires the signature of all partners.

The determination that a conveyance is given in the ordinary course of business is a matter of analyzing the facts of each case. Since most partnerships hold real property for use or long term investment, it is to be expected that you will need to require evidence of authority for most partnership conveyances. A partnership engaged in the construction of homes for resale would probably be conveying in the ordinary course of business when deeding to a home buyer. However, a large blanket construction mortgage should not be treated as “in the ordinary course of business.”

Special Mortgaging Situations

<u>Mortgage to secure obligation of less than all partners</u>: If a partner borrows funds secured by a mortgage on partnership property, you should:

a. require signatures of all general partners or written authority from all general partners, or;

if a limited partnership, require that all partners, general and limited, authorize the mortgage, and;

b. show an exception in Schedule B as follows:

Rights of the creditors of the partnership.

<u>Mortgage to secure a loan from a partner</u>: If the partnership borrows funds from one of the partners (general or limited) refer the matter to your Company underwriting advisor. In such a case you should make inquiry to determine whether the lending partner has made a full proportionate cash contribution to the firm for its share of ownership in the partnership; whether the loan funds are to be actually advanced to or for the benefit of the partnership; and whether the purpose of the loan is for a bona fide business purpose.

Insofar as such a mortgage may not have priority against the unpaid creditors of the partnership, or be deemed a preferential transfer, you may anticipate that we will take an exception in Schedule B somewhat as follows:

> *Any limitation upon the enforceability of the insured mortgage imposed or attempted to be imposed by the creditors of the mortgagor by reason of the fact that the insured is a partner in the partnership*.

Signatory Authority

Carefully consider the following issues. The partners are agents of the partnership for purpose of carrying on the ordinary or usual business of the partnership. An act of a partner which is not apparently for the carrying on of the business of the partnership in the usual way does not bind the partnership unless authorized by all the other partners, including all the limited partners in the case of a limited partnership.

Confer with your Company underwriting advisor in all of the following situations:

- Execution by a general partner of a deed in lieu of foreclosure without the consent of all partners, including all limited partners;

- Execution of a mortgage involving cross-collateralization with different borrowers (even with some commonality among borrowers) without consent of all partners, including all limited partners;

- Execution of a mortgage where the proceeds of the loan going to an entity other than the mortgagor partnership;

- Transactions where the partnership or its property is rolled up, merged, contributed, or converted to or into another entity.

Red Flags

You should consider and follow all current guidelines published by the Company on this topic.

When a transaction involves a conveyance or a financing by a general, a limited partnership (“LP”), or a limited liability company (“LLC”), all authority documents must be reviewed.

If the following RED FLAGS appear as part of your transaction, you must seek approval of Company underwriting advisor.

- A recent change in the state filings of the entity that adds or deletes parties with authority or a change in the partnership or LP or LLC agreement that attempts to do the same.

- Any transaction that involves conveyancing or mortgaging of Land by or to a partner of a partnership, must be approved by your Company underwriting advisor.

- Foreign Executions - When Partners or other entity officials are not located in the United States or the entity documents reveal the owners are not located in the United States, their signatures are to be acknowledged pursuant to our foreign notarial guidelines, including compliance with the terms of the Hague Convention, if applicable.

- Any recent amendment to the partnership, LP or LLC agreement, adding or deleting parties to the entity.

- Any variation in name, no matter how minor, in chain of title or the documentation submitted to support the chain of title.

- Any recent conveyance without corresponding financing.

Verification of Signatures
There are a number of actions you might take to verify you have the proper parties executing the instruments. If the entity has counsel, you might require that counsel to verify the signatures. If there is a key signature or a number of random signatures that you want to verify, obtain the phone number or email address of the signatories from a source other than the party that you are dealing with, and contact those signatories.

Partnerships

Changes of Partners or Dissolution

A PARTNER LEAVING THE PARTNERSHIP OR A NEW PARTNER COMING IN DOES NOT NECESSARILY AFFECT TITLE TO REAL PROPERTY HELD IN THE PARTNERSHIP NAME. A PARTNERSHIP MAY BE DISSOLVED UNDER UPA FOR A NUMBER OF CAUSES, BUT THE PARTNERSHIP IS NOT TERMINATED UNTIL THE COMPLETION OF WINDING UP OF ITS AFFAIRS.

Real property held in the name of the partnership is not affected by the addition of a new partner or the exit of an old partner so long as the firm is not dissolved and terminated. The continuing partnership may deal with assets held in the firm name as though no change of membership had occurred. You should consider the current partnership agreement as well as your state law as to the consequences of a change in membership.

Fairway Endorsement Coverage
Under the UPA, a change in membership might be deemed dissolution of the original partnership, with any agreement provision for “continuing” business deemed to describe the terms of a separate new partnership with the same name. UPA (1997) endeavors to improve this possible effect of UPA (1914) by describing “dissociations” and “continued use of partnership name.” This situation has at least two consequences you should consider: (1) the possibility that a deed is necessary to transfer the real property from the dissolved partnership to the successor entity; and (2) the effect of this on the status of the original partnership as an insured under an Owner Policy.

Consult with your Company’s underwriting advisor for the law in your state on the first issue. On the second, be aware of possible requests for “Fairway” coverage. In the case of Fairway Development Company v. Title Insurance Company of Minnesota, 621 F. Supp. 120 (D.C. Ohio 1985), a substitution of partners in the insured partnership occurred after the date of policy. A claim was presented and denied on the ground that the substitution caused the original partnership to dissolve and that with the substituted partner there existed a new entity which was not the same as the original insured. The insurers’ motion for summary judgment was granted.

"Fairway endorsements" are agreements by the Company to recognize the assignment of partner interests to the extent of not raising as a defense to a claim that the named insured no longer exists because of the assignment. It should be noted that in many states, local law would have indicated a different result than the Fairway case, that is, that a transfer of a partnership interest does not in and of itself terminate the entity.

With the adoption by ALTA in 2006 of a new Owner's Policy (6-17-06), the definition of "Insured" has been broadened considerably to expressly include, *inter alia*, "successors to an Insured by dissolution…" which should render the concerns of continued coverage addressed by the Fairway Endorsement moot and requests for the endorsement no longer necessary.

Insuring the interest of an incoming partner

A policy may be issued naming an incoming partner as the insured, or as an additional insured. If the incoming partner is the sole insured, the policy could be issued in the full amount of the value of the property or in the proportionate amount that the undivided interest acquired by the incoming partner bears to the fair market value of the land. If the policy is issued in the full amount of the value of the property, you should consider possible duplication of insurance if the partnership continues to be insured under an existing policy. It may be necessary to cancel the prior policy or to raise an exception negating the possibility that we would be asked to pay twice for the same loss. You will need to take into account whether the new policy may only insure a portion of the value when determining the policy premium.

You should review the agreement and each amendment to determine valid formation and the procedures for and consequences of substitution or addition of new partners. Copies of the documents evidencing the entry of the new partner must be reviewed for compliance with law, including consideration of proper execution. Attention should be given to the possibility that the transfer of a partnership interest may trigger various tax consequences.

Non-Imputation Coverage

The incoming partner may request an endorsement waiving any defense against a claim made under the policy which is based upon knowledge of a claimed defect, lien or encumbrance imputed to the partnership by operation of law. This coverage is for an extra-hazardous risk. You must confer with your Company underwriting advisor. **Please review the Endorsement Manual Section 15 for further discussion of these coverages**.

Imputation by operation of law may be the result of application of §12 of UPA (1914) or §102(f) of UPA (1997):

> §12. Partnership Charged with Knowledge of or Notice to a Partner. Notice to any partner of any matter relating to partnership affairs and the knowledge of the partner acting in a particular matter, acquired while a partner or then present to his mind, and the knowledge of any other partner who reasonably could and should have communicated it to the acting partner, operate as notice to or knowledge of the partnership, except in the case of a fraud on the partnership committed by or with the consent of that partner.
>
> §102(f). A partner's knowledge, notice, or receipt of a notification of a fact relating to the partnership is effective immediately as knowledge by, notice to, or receipt of a notification by the partnership, except in the case of a fraud on the partnership committed by or with the consent of the partners.

Non-imputation coverage should exclude the consequences of a possible transfer tax which may be triggered by a change in membership where no deed is recorded, if your Company underwriting advisor determines that such a risk exists.

Partnerships

Limited Partnerships

A LIMITED PARTNERSHIP FORMED UNDER THE UNIFORM PARTNERSHIP ACT MAY ACQUIRE AND CONVEY TITLE UNDER THE SAME RULES AS A GENERAL PARTNERSHIP. HOWEVER, A LIMITED PARTNER HAS NO APPARENT AUTHORITY TO ACT FOR THE PARTNERSHIP.

General

The same underwriting rules apply to insuring the title of or received from a limited partnership ("LP") as is discussed in earlier Sections Partnership1-3. Confer with your Company underwriting advisor for limitations, if any, relative to an LP formed in a different state, but owning or acquiring property in your state.

The common law does not recognize limited partnerships. Some form of the Uniform Limited Partnership Act (1916) or the Revised Act (1976) ("Act") has been adopted in all states except Louisiana. Carefully consider whether your LP was properly formed under the law of the state of its creation.

Limited Partners

Except as is provided in the Act, or in the partnership agreement, a **general partner** of an LP has the rights and powers and is subject to the restrictions of a partner in a partnership without limited partners. An LP must have one or more general partners and one or more limited partners.

The limited partners, however, do not have liabilities to other persons for the acts of the LP and the other partners, which the general partners do have, except as provided in the Act and as the Act may allow limitation in the partnership agreement.

Signatory Authority

Carefully consider the issues raised in the Partnership 2 Section. The general partners of an LP are agents of the partnership for purpose of carrying on the ordinary or usual business of the partnership. An act of a partner which is not apparently for the carrying on of the business of the partnership in the usual way does not bind the partnership unless authorized by all the other partners, including all the limited partners.

Confer with your Company underwriting advisor in all of the following situations:

- Execution by a general partner of a deed in lieu of foreclosure without the consent of all partners, including all limited partners;

- Execution of a mortgage involving cross-collateralization with different borrowers (even with some commonality among borrowers) without consent of all partners, including all limited partners;

- Execution of a mortgage where the proceeds of the loan going to an entity other than the mortgagor partnership;

- Transactions where the partnership or its property is rolled up, merged, contributed, or converted to or into another entity.

Red Flags
You should consider and follow the instructions in the Partnership 2 Section of this manual for guidelines on this issue and all current guidelines published by the Company.

When a transaction involves a conveyance or a financing by, limited partnership, all authority documents must be reviewed If the following RED FLAGS appear as part of your transaction, you must seek approval of Company underwriting advisor.

- A recent change in the state filings of the entity that adds or deletes parties with authority or a change in the LP agreement that attempts to do the same.

- Any transaction that involves conveyancing or mortgaging of Land by or to a partner of a partnership must be approved by your Company underwriting advisor.

- Foreign Executions - When Directors or other entity officials are not located in the United States or the corporate documents reveal the owners are not located in the United States, their signatures are to be acknowledged pursuant to our foreign notarial guidelines, including compliance with the terms of the Hague Convention, if applicable.

- Any recent amendment to the partnership agreement adding or deleting parties to the partnership.
- Any variation in name, no matter how minor, in chain of title or the documentation submitted to support the chain of title.
- Any recent conveyance without corresponding financing.

Verification of Signatures
There are a number of actions you might take to verify you have the proper parties executing the instruments. If the LP has counsel, you might require that counsel to verify the signatures. If there is a key signature or a number of random signatures that you want to verify, obtain the phone number or email address of the signatories from a source other than the party that you are dealing with, and contact those signatories.

Partnerships

Mergers of Partnerships with Other Business Entities

THE UNIFORM PARTNERSHIP ACT (1997) AND ALSO INDIVIDUAL SECTIONS OF STATUTES IN CERTAIN STATES WHICH HAVE ADOPTED THE UNIFORM LIMITED PARTNERSHIP ACT (1976 AND 2001) PROVIDE FOR THE MERGER OF TWO OR MORE PARTNERSHIPS, THE CONVERSION OF PARTNERSHIPS TO LIMITED PARTNERSHIPS, AND THE MERGER OR CONVERSION OF OTHER BUSINESS ENTITIES WHICH INVOLVE PARTNERSHIPS.

General

Although increasing numbers of state statutes provide for mergers or conversions involving partnerships, by no means should you assume that such a procedure is recognized in your state. Even if such a procedure is provided for, you must refer to your Company underwriting advisor any transaction where the merger or conversion has apparently occurred in reliance on the law of another state.

Other Business Entities

If the law of your state provides for merger or conversion involving a partnership and a different business entity, you must consider the law concerning the procedure and authority for the other entity to enter into the merger or conversion. Many states have coordinated their statutes on partnerships, limited liability companies, corporations, limited liability partnerships, and others. Without such coordination, confer with your Company underwriting advisor.

Policy and Commitment Issuance

Approved Forms to be Used

NO TITLE POLICY OR COMMITMENT TO INSURE IS TO BE ISSUED EXCEPT ON FORMS APPROVED FOR USE IN YOUR AREA BY YOUR COMPANY UNDERWRITING ADVISOR.

If state approval of policy forms is required, such approval will be obtained by your Company underwriting advisor before authority to use any such form is given to you. A report on title is not to be used in lieu of a commitment to insure unless you have obtained the written approval of your Company underwriting advisor, both as to the use of a report on title and also as to the form of report on title which is to be used.

Policy and Commitment Issuance

Alterations of Standard Forms Not Permitted

EXCEPT TO THE EXTENT THAT THIS DESK BOOK SPECIFICALLY PERMITS, AFTER COMPLIANCE WITH SPECIFIED PROCEDURES, THE DELETION OFSTANDARD GENERAL EXCEPTIONS IN SCHEDULE B OF THE OWNER'S POLICY AND IN SCHEDULE B OF THE COMMITMENT TO INSURE, NO ALTERATION OF ANY OF THE STANDARD PROVISIONS OF A POLICY OR COMMITMENT FORM IS PERMITTED UNLESS THE PRIOR WRITTEN APPROVAL OF YOUR COMPANY UNDERWRITING ADVISOR HAS BEEN PROCURED. DO NOT ISSUE A LETTER OR A MEMORANDUM WHICH ATTEMPTS TO EXPLAIN OR TO EXPAND THE COVERAGE GIVEN BY AN APPPROVED FORM.

Although there may be some difference in format or arrangement within the form, our policy forms are composed of five components which are the COVERED RISKS (PREVIOUSLY DESCRIBED AS INSURING CLAUSES), SCHEDULE A, SCHEDULE B, EXCLUSIONS FROM COVERAGE and the CONDITIONS. In some of the policy forms, the EXCLUSIONS FROM COVERAGE are found either as printed provisions in SCHEDULE B or as items in the CONDITIONS. Although it is appropriate for you to submit to your Company underwriting advisor requests for modifications or changes in the COVERED TITLE RISKS, EXCLUSIONS FROM COVERAGE or CONDITIONS, permission to make such changes is rarely granted and your Company underwriting advisor will authorize them only after your Company underwriting advisor has obtained the approval of the appropriate level underwriter within the Company.

Alteration means either deleting all or a part of the standard provisions or inserting additional language in the policy form. The use of endorsements to alter or explain any of the standard provisions is prohibited unless all procedures which permit the amendment by endorsement are complied with. You are not authorized under any circumstances to issue a letter or a memorandum which attempts to explain, construe or expand the coverage of any of our forms.

SCHEDULE A is a standard form. On SCHEDULE A you are not authorized to make any changes in any of the standard language in the schedule as it is supplied to you. It is necessary that you add language to this schedule before the policy is delivered and this is discussed further in the Policy and Commitment Issuance 3.

SCHEDULE B also is a standard form. In most cases it will be necessary that you add additional exceptions in SCHEDULE B, depending, of course, upon the circumstances of the particular case. You will also find in Section Policy and Commitment Issuance 6 instructions which permit the deletion of certain of the standard general exceptions in the form of SCHEDULE B which is to be attached to the owner's policy. Except to the extent that these instructions authorize you to delete the standard exceptions in SCHEDULE B, and only as to those exceptions, and only after you have complied with the requirements in the instructions, you are not authorized to delete or alter any other of the printed provisions of SCHEDULE B.

The provisions on the cover sheet or first page of the ALTA Commitment should be referred to as Contractual Provisions rather than Covered Risks or Insuring Provisions. They and the Conditions within the Commitment are not to be altered without the approval of your Company underwriting advisor.

Policy and Commitment Issuance

Completion of Schedule A

THE PURPOSE OF SCHEDULE A IN THE POLICY AND COMMITMENT FORMS IS TO MAKE THE INSURING OR CONTRACTUAL PROVISIONS APPLICABLE TO THE PARTICULAR LAND AND INTEREST THEREIN UPON WHICH THE INSURANCE OR COMMITMENT TO AFFORD INSURANCE IS BEING ISSUED. THE COMPONENTS OF SCHEDULE A ARE THE IDENTIFYING FILE/COMMITMENT OR POLICY NUMBER, THE AMOUNT OF INSURANCE AFFORDED OR TO BE AFFORDED, THE EFFECTIVE DATE, THE NAME OF THE INSURED OR OF THE PROPOSED INSURED, THE ESTATE OR INTEREST IN THE LAND WHICH IS COVERED OR TO BE COVERED, THE OWNER OF THAT ESTATE OR INTEREST, THE LAND TO WHICH THE ESTATE OR INTEREST APPLIES, AND, IN THE CASE OF THE MORTGAGE POLICY, THE IDENTIFICATION OF THE SECURITY INSTRUMENT TO WHICH THE POLICY OR COMMITMENT APPLIES.

Without the completion and insertion of SCHEDULE A in a title policy or commitment, the insuring provisions or the contractual provisions are meaningless. Consequently, you are required to complete SCHEDULE A before either a policy or a commitment is delivered.

The inserts which are to be made in SCHEDULE A vary according to whether a title policy or commitment is to be issued and according to the type of policy which is being issued.

Two items in SCHEDULE A, however, require the same treatment in the commitment and in all of the different types of policies. These are, first, the manner in which title to the estate or interest described or referred to is vested at the effective date of the policy or commitment and, second, the manner in which the Land is to be described.

In the policy forms, where the Land is described may vary, it is usually the last item on Schedule A and may be shown by reference to an Exhibit or to SCHEDULE C, depending on the local forms used.

Describing the Owner(s) of the estate or interest referred to

1. Name of the owner(s) - Use the name as it appears in the instrument of conveyance whereby title became vested in the owner(s), but if different names appear in more than one vesting instrument or other instruments in the chain of title, such as a mortgage, list all the names. (*Example - John Jones, also known as John J. Jones, also known as J. James Jones).*

2. Marital status of owner(s) - Do not show marital status in the Name of Insured clause in the policy. In the Commitment, if an owner appears to have a spouse and the Land is located in a state where the spouse must join in any instrument affecting ownership, show the name of the spouse by adding it immediately following the name of the owner. (*Example – <u>[owner]</u>, whose spouse's name, as shown by instruments of record, is _____________).*

3. Identification of owner(s) - Do not give addresses or other geographical information for an owner who is a natural person. Show the state of incorporation of a corporation, viz*., The Jones Company, an Illinois corporation*, but do not indicate whether a corporation organized in a state different than that in which the land is located has qualified to do business in that state.

4. Quantity and nature of ownership - If there is more than one owner and the ownership is in common, show the quantity owned by each, viz., *John Jones and Peter Smith, each as to an undivided one-half interest* or *John Jones as to an undivided two-thirds interest and Peter Smith as to an undivided one-third interest.* In a commitment you may show the ownership in joint tenancy, if stated on the vesting deed; viz., *John Jones and Mary Jones, husband and wife, as joint tenants.* If it is by the entirety, so state, viz., *John Jones and Mary Jones, husband and wife, as tenants by the entirety*. If the manner of ownership is different in different quantities so state, viz., *John Jones as to an undivided two-thirds interest, Peter Smith and Susan Smith, husband and wife, as joint tenants as to an undivided one-third interest.*

5. Character of ownership - If the owner holds in a fiduciary or representative capacity, so state. If title is vested in a guardian (as contrasted with the case where the title is in the ward, but subject to the control of the guardian) you must so state; viz., *John Jones as guardian (conservator) of the estate of Peter Smith, a minor (an incompetent)*. If title is vested in the executor(s) or administrator(s) of a decedent's estate (as contrasted with title being in the heirs or devisees who should

then be individually identified) you should so state; viz., *John Jones executor (administrator) of the estate of Peter Smith, deceased.*

Describing the Land Referred To

1. Use the description ascertained by the title searches for the commitment and in the commitment for the policy provided the deeds or mortgages made after the commitment issuance convey all the land described in the commitment.

2. Do not include reference to acreage, square footage or other specific area measurements (i.e. "containing 3.75 acres, more or less") unless you raise the appropriate exception in Schedule B that the policy does not insure acreage. If the description is based upon acreage (i.e. "the West 20 acres of the NW quarter…") you must ascertain from an accurate survey that the land described actually includes the specified area measurement and you intend the policy to insure that the description includes that quantity of land. If you are unable to do so, you should raise the same exception.

3. Do not, by incorporating by reference or by copying the description from an instrument of conveyance or mortgage, include items of personal property in the description the ownership of which we do not intend to insure.

4. If the Land is composed of two or more parcels which have been separately described in prior conveyances, describe each parcel separately numbering them as Parcel 1, Parcel 2, etc. If you are requested to consolidate these parcels into one overall or perimeter description, do not do so unless the record examination shows that such parcels are sufficiently contiguous so that they can be described as one parcel and you have further verified from an accurate survey that no gores or gaps exist between the parcels which would cause them not to be contiguous. The adjacent land descriptions need to be examined to verify that the new description does not cause any overlap or other boundary problem, and boundary lines are properly described in relation to historic monuments or ownership. The new description should not create any ambiguity with the adjacent properties and must conform to state requirements and the local statute of frauds or recording acts. In some areas of the country you may not be able to combine historic descriptions.

5. If the Land consists of two or more parcels in which different estates or interests are owned, as for example where

the first parcel is owned in fee and the second parcel is a leasehold estate or where the interest in the second parcel is an easement, use the description of the Land. The <u>nature</u> of the estates should have been previously shown in Item 2 of Schedule A and you must be sure that your identification of the parcels in Item 5 as Parcel 1, etc., correspond to the parcel numbers used in Item 2 for the different estates or interests.
For example, if item 2 identifies *Fee Simple as to Parcel 1 and Easement as to Parcel 2,* make sure the proper legals are shown for each estate.

6. Do not include any part of the land the fee ownership of which is not owned by the person described as being the owner of the estate or interest covered. Example: if a part of the land has been condemned for highway or other purposes and the effect of such condemnation is to vest the fee simple title to that part in the condemner, do not include the condemned tract in the description and then attempt to eliminate it from the policy by a SCHEDULE B exception. Instead, except that part from the description either by an adequate description of the land so condemned or that part condemned, taken or conveyed by a certain action or deed.

On the other hand, if the interest condemned was only an easement, then describe the part so affected in the description without making reference to the easement but make an appropriate exception of the easement as affecting that part of the land in SCHEDULE B. It is proper nevertheless, for emphasis, to except a part owned in fee in SCHEDULE B as well as in the description and to make reference to an easement ("subject to") in the description as well as excepting the easement in SCHEDULE B. It is not appropriate to only show the easement burdening the property in Schedule A without raising an exception for it in Schedule B, unless directed by your Company underwriting advisor.

7. Keep in mind that a description of a tract of land includes not only the surface of the land which is located within the boundaries identified in the description but also includes all the air space above it, all of the soil beneath it, all of the things growing on it and all improvements attached to it which have become fixtures or real property under state law and included within the definition of Land in the policy. If it is your intent **not** to insure all of these elements of the Land, it is necessary that you either except in the description those elements which you do not intend to insure or that you specify only those elements which you intend to insure. Examples are particular minerals,

particular buildings, or that part of the land lying above or below a specified horizontal plane. Do not include the entire land in the description and then attempt to exclude some of its elements by a SCHEDULE B exception only.

Policy and Commitment Issuance

Schedule B-Purpose

THE PURPOSE OF SCHEDULE B IS TO LIST MATTERS WHICH ARE IN EXISTENCE AS OF THE DATE OF THE POLICY, BUT WHICH ARE EXCEPTIONS TO THE POLICY COVERAGE.

AN EXCEPTION OF LIABILITY OF ANY SUCH MATTER MUST CONSTITUTE AN ACCURATE IDENTIFICATION OF THE MATTER WHICH IS BEING EXCEPTED.

Exceptions in SCHEDULE B are either general or special. General exceptions cover matters which require an additional search or investigation in order to determine whether they are, in fact, in existence. Special exceptions cover the specific matters which exist, or are believed to exist, on the effective date of the title policy. See Policy and Commitment Issuance Sections 5 and 7 immediately following.

Policy and Commitment Issuance

General Exceptions

DO NOT ISSUE EITHER AN OWNER'S POLICY OR A LOAN POLICY UNLESS IT CONTAINS IN SCHEDULE B THE GENERAL EXCEPTIONS WHICH ARE LISTED IN THIS SUBTOPIC OR UNLESS YOU HAVE BEEN SUPPLIED WITH THE INFORMATION WHICH JUSTIFIES THEIR OMISSION. THESE EXCEPTIONS, ALTHOUGH GENERALLY RELATED, SHOULD BE TREATED ON AN INDIVIDUAL BASIS AND YOU MAY DECIDE THAT YOU HAVE BEEN FURNISHED INFORMATION SUFFICIENT TO JUSTIFY THE OMISSION OF ONE OF THE EXCEPTIONS BUT THAT THE OTHERS MUST BE SHOWN.

The basic underwriting risk which we assume when we issue a policy is that which we assume when we issue a title policy containing our General Exceptions. If we issue a policy which does not contain all of these exceptions, we have assumed a greater risk and we are not willing to assume that greater risk based upon the searching and investigative procedures which we use to decide to assume the basic risk.

The General Exceptions are intended to cover all matters which might affect the title within a given category if any such matters do exist. These exceptions, and the reason why our usual procedures are not adequate to disclose whether there are any matters in existence at the date of the policy which are within the scope of the exceptions are:

1. Rights or claims of parties in possession not shown by the public records - whether any such rights are in existence requires a physical inspection of the land and inquiry of those who are familiar with its use.

2. Any encroachment, encumbrance, violation, variation, or adverse matter affection title that would be disclosed by an accurate survey and complete land survey of the Land - requires an accurate survey and, in some cases, a physical inspection.

3. Easements or claims of easements not shown by the public records - requires an accurate survey, an inquiry to the sellers, a physical inspection and

also an inspection of adjacent lands and of other official records to determine whether any such easements exist either on, above, or below the surface of the land.

4. Any lien, or right to a lien, for services, labor, or material heretofore or hereafter furnished, imposed by law and not shown by the public records - requires a physical inspection and possibly other inquiry to determine whether any improvements on the land have been recently constructed, altered or repaired and, if so, whether the charges incurred for services, labor, or material have been paid.

5. Taxes or special assessments which are not shown as existing liens by the public records - includes those which may presently constitute liens but are not shown by records considered to be public records, or which, when established as liens in the future, have a retroactive effect so as to predate the effective date of the policy.

You are not authorized to issue any title policy either owner's or loan, which does not contain these general Schedule B exceptions, as promulgated for your state, unless you have made the additional searches and investigations described in the Section 6 herein and have inserted, in lieu thereof, in Schedule B, any additional special exceptions which are necessary because of facts or matters disclosed by those additional searches and investigations. If the preprinted or digital form of Schedule B form supplied to you does not contain these General Exceptions, you must add them in unless, once again, you have made the additional searches and investigations to determine that they are not necessary.

In some areas, additional General Exceptions are necessary. If you are operating in such an area, these will either appear on the standard Schedule B inserts furnished you for use on an owner's policy, or you will be, or will have been, notified of them by your Company underwriting advisor. These exceptions also must appear in Schedule B in any title policy, either owner's or loan, unless you have been supplied with information which justifies their omission.

Note that all of the General Exceptions first listed above are directed at matters which are not disclosed by the public records. You should not rely on one of these exceptions, consequently, to except a matter which appears in the public records or which is referred to by a matter appearing in the public records.

Policy and Commitment Issuance

Deletion or Omission of General Exceptions

A GENERAL EXCEPTION MAY BE DELETED OR OMITTED FROM SCHEDULE B ONLY AFTER YOU HAVE MADE THE SEARCHES AND INVESTIGATIONS HEREAFTER SPECIFIED AND HAVE DETERMINED THAT THERE IS NO MATTER AFFECTING THE LAND WHICH IS WITHIN THE SCOPE OF THE GENERAL EXCEPTION. IF THE SEARCHES AND INVESTIGATIONS DISCLOSE ANY SUCH MATTER(S), YOU MUST INSERT A SPECIAL EXCEPTION AS TO THE MATTER(S) DISCLOSED. ***YOU MAY BE IN AN AREA THAT HAS SPECIFIC INSTRUCTIONS THAT DIFFER FROM THOSE SHOWN HERE. ALWAYS COMPLY WITH THE DIRECTIONS OF YOUR COMPANY UNDERWRITING ADVISOR FOR YOUR STATE.***

Historically we have been more reluctant to delete the GENERAL EXCEPTIONS in an owner's policy than we have been in a loan policy. This reluctance is due to the belief that (a) an owner might be concerned with matters which would not be considered serious by a mortgagee; (b) that the value of the owner's equity might be sufficient to insulate the mortgagee (and thereby, us) against loss as to many matters; and (c) that the continuing liability under an owner's policy makes the coverage a greater exposure than we had under a reducing and usually finally terminated loan policy. While the validity of these reasons, may be questionable, you are still required in some instances to vary your procedures as between owners and loan policies. These variances are specified in the following discussion.

For purposes of discussion, the following are considered General Exceptions with their corresponding number. The exact terminology or numbering of these may vary by state. The number of them may also vary.

- General Exception 1 – Rights of Parties in Possession
- General Exception 2 – Survey matters
- General Exception 3 – Unrecorded Easements

- General Exception 4 – Mechanics' or Construction Liens

The majority of the information which you need in order to determine whether GENERAL EXCEPTIONS 1, 2, 3 and 4 can be omitted is detailed on the Standard Extended Coverage Questionnaire. This is sometimes called the ALTA form or the Owners Affidavit as to Possession and Liens. In addition, you should know the general geographic area of the Land and if there are restrictive covenants or easements affecting the Land.

You should obtain a Standard Extended Coverage Questionnaire before deleting any of GENERAL EXCEPTIONS 1, 2, 3 and 4 (as identified in the <u>Policy and Commitment Issuance 6</u> Section of this manual) in any owner's policy. You should not assume, however, that the information supplied by this questionnaire is accurate and complete. Its purpose is to supplement the information which should be revealed from an accurate survey of the land and from a personal inspection of the land by a person skilled and experienced in determining whether any adverse matters are disclosed by the physical condition of the land.

Making an accurate survey requires the use of a surveyor's expertise, which is usually not possessed by members of your staff and, consequently, unless you have the written authorization of your Company underwriting advisor to have surveys, or their equivalent, made by members of your own staff, you must obtain a survey from a surveyor or surveying company. Similarly, although you may be equipped to make an informed inspection, it may not be economically or physically feasible to do so in many cases and, consequently, you will be asked to rely upon information furnished by some person(s) outside your employ.

You have the responsibility for making the determination in each case as to whether both the survey, owner's statement and the inspection information furnished you are sufficient for our purposes. Note that when we issue a title policy based upon a survey and inspection information given us by persons not in your employ, we have assumed a liability to our insured which may result in a substantial loss to us if the survey and information furnished is not accurate and complete. While it obviously is impossible to be absolutely certain, you must use your best judgment in deciding whether the survey and information furnished are probably accurate and complete.

In reaching this decision, you should always have in mind the particular type of transaction involved. Have in mind the kinds of matters frequently disclosed by surveys and inspections. Ask yourself whether any of these matters are more likely to be involved in your transaction and, if so, whether the survey and inspection, which you have, will probably disclose the existence of these matters.

In determining the acceptability of the survey, ask yourself the following questions:

1. What is the reputation and experience for accuracy and reliability in the community for the surveyor or surveying company which has made the survey?

2. While this reputation and experience may be adequate for residential transactions, is it adequate for a transaction affecting commercial property where the improvements extend to the boundary lines of the land and where there may be encroachments not only on the surface but in the air space above or the space beneath the surface of the land?

3. Does the certificate attached to the survey cover all of the matters described by our surveyor's report? If it does not, are you satisfied that you have accurate information from other sources to overcome the shortcomings of the certificate? (If the certificate is deficient in any owner's policy which involves land other than that used for an ordinary single-family residence, you should **not** use it as a basis to delete the matters that are not certified to.)

In considering the probability that inspection information is accurate and complete, ask yourself the following questions:

1. If the information is being furnished by some person involved in the transaction, such as a vendor or an owner where a mortgage policy is issued, is the probability of bias sufficiently strong that you should require verification of the statements?

2. If the information is being supplied by some person who is not a party to the transaction, is the information based upon an actual recent inspection of the property or from some other source and, if the latter, is

that source adequate to inform him as to the statements which he is making?

You should be able to decide from the survey and inspection report whether you can delete or omit Exceptions 1 and 2. While they are helpful in connection with Exception 3, it may be necessary to get additional information to determine whether there are underground easements or implied easements of access which would not be disclosed.

The information furnished by the survey and inspection also may be helpful in connection with Exception 4, but, once again, may not be complete. There may have been substantial repairs or alterations made inside an improvement which are not apparent from an inspection of the exterior. It also is not always possible to determine exactly when recent improvements were completed and the date of the completion may be critical in determining whether the right to file a lien for the matters specified in Exception 4 has elapsed.

The survey and inspection, once again, may be helpful in connection with Exception 5 (Taxes) in that ongoing or recently completed public improvements may indicate the possibility of outstanding special assessments. But the survey and inspection information are not sufficient for you to decide either that there are, or are not, taxes and special assessments outstanding which may be excluded by the exception.

General Exceptions, Owners Policies Ordinary One To Four Family Residences

In some areas of the country it is our policy to delete or omit GENERAL EXCEPTIONS 1 to 4 inclusive on any owners policy where the land is improved with a structure intended for ordinary residential use by not more than four families if we are simultaneously issuing a loan policy involving the same land in which we do not show these exceptions. The intent is that the information which justifies the absence of these exceptions from the loan policy is also sufficient to justify the same treatment in the owner's policy. If you are using some basis other than the collection and analysis of the information previously discussed to remove a general exception from the loan policy, you will need to collect the information and documentation to delete the exception from the owners policy.

There are, however, two important exceptions to this policy. The first is that unless the survey furnished is sufficiently complete to show the fences, plantings and the like improvements along the boundary lines, you must insert in lieu of GENERAL EXCEPTION 2 the following:

> *Any discrepancy between the actual boundaries of the land and the apparent boundaries indicated by fences, plantings or other improvements.*

The second relates to mechanics' liens. You may not delete or omit Exception 4 from the owner's policy simply because it does not appear in the loan policy unless you justify its absence from the loan policy on the basis that the improvements have been fully completed and that all bills for labor and material have been paid. If you are relying in any way upon indemnity agreements or deposits to support the absence of the exception in the loan policy, be sure that the terms of the agreement or deposit are broad enough to indemnify us for losses under the owner's policy, and the indemnitor is credit worthy. If our indemnification for the loan policy is from the owner who is being insured by the owner's policy, do not delete the exception. Any request to rely upon an indemnity to delete these exceptions must be discussed with your Company underwriting advisor.

Procedure For Deleting Or Omitting General Exceptions
If the standard schedule B insert which you are using does not contain preformatted GENERAL EXCEPTIONS and you have obtained information which justifies the issuance of a policy without the exceptions or any of them, you should not enter in the GENERAL EXCEPTION which you intend to omit. Your file, however, should contain sufficient information to establish clearly the basis on which the exception was omitted.

If the Schedule B insert does contain these preformatted exceptions and you have obtained information sufficient to justify the deletion of any of them before the policy is issued, strike through the exception or exceptions to be deleted, have the alteration initialed by the authorized signatory on the policy and also type in Schedule B the following:

> *NOTE: Exception(s) #_____ shown above is/are deleted.*

You should insert only the numbers of the exceptions which you intend to delete and tailor the language according to whether one or more exceptions are being deleted.

If the policy has been issued containing one or more GENERAL EXCEPTIONS which you can now delete because of information obtained after the issuance of the policy, attach an endorsement form to the policy after inserting in the form the following:

> *Exception(s) # _____ shown in Schedule B is/are deleted*.

Premium Charges
In deleting or omitting GENERAL EXCEPTIONS from Schedule B, you must be governed by your state filings as to charges and also any instructions given by the Company relative to additional charges for deleting any of these GENERAL EXCEPTIONS.

Special Exceptions In Lieu Of General Exceptions
Do not overlook, when you are deleting or omitting a GENERAL EXCEPTION, the necessity for inserting a special exception of any adverse matter disclosed by the survey and inspection, or other documentation relied upon to delete a general exception. For example, if the owner's affidavit reveals tenants in possession, the general broad exception for possession may be deleted but a special exception must be raised for the particular interest disclosed, such as "*Rights of tenants under unrecorded leases."*

Policy and Commitment Issuance

Special Exceptions

YOU ARE REQUIRED TO MAKE A SPECIAL EXCEPTION IN SCHEDULE B FOR ANY MATTER DISCLOSED BY OUR SEARCH AND INVESTIGATIVE PROCEDURES WHICH YOU BELIEVE CONSTITUTES A MATTER INSURED AGAINST BY THE COVERED RISKS IN THE TITLE POLICY WHICH IS TO BE ISSUED AND WHICH YOU ARE NOT AUTHORIZED TO ACCEPT AS AN INSURABLE RISK UNDER THE INSTRUCTIONS SET FORTH IN THIS DESK BOOK.

You must phrase the exception which is inserted in Schedule B to describe the special matters for which we are unwilling to assume liability and which are in existence at the policy date. While many of these matters (mortgages, easements, restrictive covenants, leases, etc.) can be incorporated in a standard format, you must not only decide the information which is to be inserted in the format but also whether the format selected is adequate to cover the matter which you are attempting to except.

Two fundamental principles apply to phrasing these exceptions. The first is that the exception must be sufficient to inform the Insured as to the nature of the matter being excepted as well as to excuse us from liability for that matter. The second is that any ambiguity in the exception which requires judicial interpretation will be construed favorably to the Insured and unfavorably to us. You should apply the following rules to implement these principles:

1. Do not use a Schedule B exception alone to exclude from the policy the <u>ownership</u> of a part of the Land, whether the part is a specific area within the described area or a component of the land, such as mineral, improvements, air space, etc., but instead you should exclude that part from the description in Schedule A. See section, Completion of Schedule A.

2. Identify the general nature of the matter being excepted such as “mortgage”, “easement”, “lease”, “covenants and restrictions” preferably by the initial word or words of the exception but be certain that the term used is broad enough to include all of the rights being excepted. (Example - “covenants and restrictions” may not be broad enough to except an

easement granted or reserved for utility purposes even though such easement is established or provisions are contained in a list of “covenants and restrictions.” Likewise, any options, assessment rights or rights of approval of subsequent owners or occupants must be shown). Verify with your Company underwriting advisor as to additional matters which must be specified in each exception. **You must follow the guidelines for showing the types of terms that should be set out specifically for the issuance of the ALTA 9.6-06 (Private Rights) Endorsement. Please refer to Endorsement Manual Section 9 for further instructions.**

3. Identify the part of the land affected, if only a part is affected.

4. If a lien, such as a mortgage, or taxes and assessments, is being excepted, and the lien affects additional land, so state.

5. Identify by book and page of the record (or other designation used in that county or city) where the matter can be found if it appears in the public record and, if it is not recorded or referred to in the public records, phrase the exception to show clearly that it is not a matter of public record.

6. If your exceptions contains restrictions that violate any federal or state protected issues, such as race, age, religious affiliation, etc. you must follow the guidelines in Section Restrictive Covenants 1 herein.

Policy and Commitment Issuance

Insuring over General or Special Exceptions

NO GENERAL OR SPECIAL EXCEPTION IS TO BE OMITTED FROM SCHEDULE B BECAUSE OF THE DEPOSIT OF INDEMNITY WHICH IS INTENDED TO PROTECT US AGAINST FINANCIAL LOSS BY REASON OF SUCH MATTERS. IT IS PROPER, NEVERTHELESS, TO SHOW CERTAIN MATTERS AS EXEPTIONS IN SCHEDULE B AND THEN TO GIVE INSURANCE AGAINST LOSS ARISING FROM THE ENFORCEMENT OF SUCH MATTERS PROVIDED THE PROCEDURES SPECIFIED IN THIS SUBTOPIC ARE FOLLOWED. DAMAGES THAT ARE TO BE COVERED OR EXCLUDED BY THE INSURANCE SHOULD BE SPECIFIED.

If your examination and other investigation show the existence of a defect, lien or encumbrance, a lack of a right of access, unmarketability of title or any other matter which you would ordinarily show as a Schedule B exception, you must not omit showing that matter because you have been furnished with indemnity which you believe to be sufficient to pay the damages which we might be obligated to pay to the Insured if that matter results in loss or damage to the Insured. On the contrary, you must show the matter as an exception. As to certain matters, however, you are authorized to add a special insuring clause stating, with certainty, the protection which we are willing to afford in connection with that matter.

This requirement is necessary for four reasons: (1) The matter in question usually will impair the marketability of the title and, if the policy being issued insures against loss arising from unmarketability, our Insured, as to the type of matters under discussion, should be aware that the title is not eligible for marketability insurance. (2) Although we deny that we have any obligation which extends beyond the terms of the policy which we have issued, some courts have stated that there may be a duty to inform the Insured as to all outstanding matters of record. Some of our national customers such as FNMA and GNMA and many life insurance companies have stated that they expect to be informed as to such matters by us. (3) The loan policy requires us not only to insure the validity and priority of the lien of the Insured Mortgage but also to show in Schedule B all matters which affect the mortgagor's title as of the policy date. (4) If any commitment, report or policy is to be used to show the status of title to any subdivision regulatory authority, all exceptions to the title must be shown. UNDER NO CIRCUMSTANCES SHOULD ANY OUTSTANDING INTEREST, LIEN OR ENCUMBRANCE, WHICH ACTUALLY AFFECTS THE TITLE TO THE LAND, BE OMITTED FROM SUCH COMMITMENT, REPORT OR POLICY.

You are not expected, under the foregoing rule, to make an exception of a lien which has in fact been paid as of the policy date but for which the satisfaction of record has not yet been made, such as the mortgage that was paid off in the current transaction, if we have paid the lien or have sufficient evidence that the lien has been paid. Neither does it require you to make a special exception of matters which may be unenforceable because of statutes of limitation or other curative acts or which you believe do not actually impair the title. The rule is directed at matters which do affect the title and must be disposed of at some time in the future.

If you are requested to give “affirmative” insurance over matters which cannot be satisfied by the payment of an ascertainable sum of money, submit the request to your Company underwriting advisor.

We do have procedures for insuring over restrictive covenants under certain circumstances and over certain encroachments. Except as noted above, the only matters which you are permitted to show and insure over are liens which can be satisfied by the payment of a sum of money which, in turn, can be predetermined at the time the policy is issued. Without the express approval of your Company underwriting advisor, however, you are not authorized to give such assurance unless the indemnity deposited with us is in cash and unless the amount has been computed in accordance with the procedures described in Company Guidelines. A reminder that the indemnity must run to the Company (not the agent) and all funds must be held by the Company.

Some indemnity agreements limit our rights to eliminate a lien by payment prior to the time that its enforcement might impair the ownership of our insured. In other words, the insured might suffer loss by reason of the unmarketability of the title prior to its attempted enforcement and we, on the other hand, would not be permitted under the terms of the indemnity agreement to correct the unmarketability by payment of the lien. We do not intend to insure over unmarketability or other interim damages occurring before final judgment or decree or sale. Consequently, the special insuring clause should be phrased so as not to insure against loss or damage by reason of the existence of the lien but only by reason of direct loss resulting from a final judgment or decree or other final action, such as the sale of the property pursuant to a power of sale in a trust deed.

The language “enforcement or attempted enforcement” should not be used when insuring over.

When you have the properly funded indemnity agreement, you should use one of the following forms of affirmative coverage.

The first form is designed for use when insuring over a lien which can be enforced by judicial proceedings resulting in a judgment or decree:

> *The Company insures the Insured against loss or damage sustained by the Insured by reason of a judgment or decree which constitutes a final determination and orders full or partial satisfaction of the __________ excepted at No. __________ of Schedule B against the land described in Schedule A as a lien encumbering or having priority over the estate or mortgage insured by this policy.*
>
> ******The Company does not insure against any loss or damage sustained by the Insured by reason of the pendency of any action or proceeding wherein such a judgment or decree or any appeal therefrom is sought, including without limitation damages from any effect on the marketability of the title, but the duty to provide defense pursuant to Paragraph 5(a) of the Conditions is applicable.*

The second form is designed for use when insuring over a lien which can be enforced by a non-judicial sale, such as a sale by a trustee under a power of sale.

> *The Company insures the Insured against loss or damage sustained by the Insured by reason of a sale for the purpose of full or partial satisfaction of the _________ excepted at No. _________ of Schedule B against the land described in Schedule A as a lien encumbering or having priority over the estate or mortgage insured by this policy.*

The Company does not insure against any loss or damage sustained by the insured which occurs prior to the sale referred to herein, including without limitation damages from any effect on the marketability of the title, but the duty to provide defense pursuant to Paragraph 5(a) of the Conditions is applicable.

*****This paragraph may be deleted if the indemnity agreement gives us the unqualified right to pay the lien at any time.

Please review the Endorsement Manual Section 34 for further discussion of these coverages.

Some customers may request that the special insuring clause be made more specific with reference to the exception. You may comply with this request but the phrasing employed will vary with the nature of the exception. The language used, however, must neither expressly nor by implication protect beyond loss arising after a final judgment or decree, exercise of a power of sale, etc. and from those costs of defense provided for in the Conditions. Any requests for modification must be discussed with your Company underwriting advisor.

Policy and Commitment Issuance

Endorsements

AN ENDORSEMENT IS TO BE ATTACHED TO A TITLE POLICY WHEN IT IS OUR INTENTION TO ALTER OR MODIFY THE PROVISIONS OF THE POLICY SO THAT THE INSURED RECEIVES A GREATER COVERAGE, AND WE HAVE INCURRED A GREATER LIABILITY, THAN EXISTED UNDER THE UNENDORSED TITLE POLICY. DO NOT USE AN ENDORSEMENT TO LIMIT THE LIABILITY UNDER A TITLE POLICY WITHOUT THE APPROVAL OF YOUR COMPANY UNDERWRITING ADVISER.

All Endorsements are to be on printed Company forms although some of the forms may require the insertion of applicable language by you to accomplish the purpose of the endorsement.

PLEASE REFER TO THE COMPANY ENDORSEMENT MANUUAL AND OTHER COMPANY GUIDELINES FOR DISCUSSION OF PARTICULAR REQUIREMENTS FOR THE ISSUANCE A SPECIFIC ENDORSEMENT.

Policy and Commitment Issuance

Advancement of Policy by Date Down Endorsement

ADVANCING THE EFFECTIVE DATE OF A POLICY TO A LATER DATE REQUIRES A COMPLETE REEVALUATION OF OFF-RECORD MATTERS, AS WELL AS A RUN-DOWN SEARCH AND EXAMINATION OF THE RECORDS.

When the effective date of the policy (Date of Policy) is changed to a later date, all aspects of the insurance afforded by the policy speak as of the later date. Therefore, if taxes or special assessments have been levied, if persons with unrecorded rights have been put into possession, if construction has taken place which encroaches over boundary lines or into easements or setback zones, or if any event has occurred which would adversely affect the insured interest, we may be exposed to loss if such matter is not excluded or excepted in Schedule B when such date down is provided. Therefore, if the Date of Policy is to be advanced, it is necessary to obtain as complete information and to provide as thorough an underwriting consideration as would be given for the initial issuance of such a policy.

Additional Advances

Changing the Date of Policy raises particular problems if additional advances of mortgage loan proceeds under an Insured Mortgage have been disbursed, such as in the case of a construction loan. Even when the construction loan mortgage had original priority, the continuation of that priority may be affected by off-record matters, and even when the facts are disclosed, their effect upon the continued priority of the mortgage may be difficult to evaluate.

For example, were the additional advances made within the scope of the original mortgage loan agreement and the terms of the mortgage? If not, some part or all of the advances may not be secured by the mortgage. If a disbursement is made by the lender which is not obligatory upon it under the terms of the construction loan documents, the priority date of the mortgage as to such disbursement may be the date it is paid out instead of the date the mortgage was recorded.

The determination of whether or not such impairment of priority will occur is often very perplexing in the light of the complexities of the construction loan agreement and the facts of the situation. It is possible, if we had sufficient access to the facts, that we might be estopped to deny liability as to any such impairment of priority. In other words, we might lose the policy defenses that it was a matter known to the Insured and not known to us or a condition created, suffered or agreed to by the Insured.

Partial Date Down
Ordinarily, the primary purpose for a requested date down is simply to determine whether unexpected matters have been placed of record. Therefore, instead of issuing an endorsement advancing the Date of Policy or commitment, it is recommended that the results of a record search from the original Date of Policy or binder be covered in an endorsement in substantially the following form:

The Company hereby insures against loss or damage arising from the effect of any instrument recorded in the public record affecting the title to the Land or the lien of the Insured Mortgage subsequent to (effective date of the binder or policy or last previous record search endorsement) and prior to (date of current record search) except the following: (Insert all instruments found in the run-down search.)

Such endorsement should be put on the standard blank form of endorsement.

Full Date Down
If a complete date down of the policy is insisted upon, it is necessary not only to have the continuation of the record search and examination, but also a continuation of the tax and assessment search and the addition of exceptions concerning any taxes or assessments which shall have become liens subsequent to the original date of the policy and which remain unpaid.

It will also be necessary to reevaluate all off-record aspects of the title, including, without limitation, obtaining a recertification of the survey or otherwise obtaining satisfactory evidence that there has been no significant change in the facts as would be shown by the survey. Otherwise, unless the original policy contained full survey exceptions, it will be necessary that the date-down endorsement add to Schedule B the following exception:

The effect of any facts or circumstances occurring subsequent to (insert the original date of policy) which would be disclosed by an accurate survey and inspection on the premises.

Title Changes Shown In Schedule B

All changes in the title to the property as shown by the run-down search and all liens and encumbrances that are disclosed must be inserted in Schedule B of the policy by the date down endorsement. Problems may arise as to whether the Company should give assurance that such matters are junior and subordinate to the Insured Mortgage or whether they have assumed superiority to the lien of the Insured Mortgage.

If the date down endorsement is to cover additional advances under the mortgage, particularly with respect to a construction loan mortgage, the question of whether or not the mortgage retains priority over such intervening matters, including unfiled mechanics' liens, is particularly important.

Unpaid taxes and assessments must go in Schedule B and be without any insurance of the priority of the Insured Mortgage as to amounts disbursed subsequent to the lien date of such taxes and assessments. Any other mortgage, lien, encumbrance or interests which the issuing office or agency believes for any reason to be equal to or superior to the lien of the Insured Mortgage should be shown in Schedule B and without any insurance as to the priority of the Insured Mortgage over such matter as to disbursements made after their respective effective dates.

If it is determined that other matters attaching to the title subsequent to the original Date of Policy are subordinate to the lien of the Insured Mortgage, those items may be shown, as added to Schedule B, with the following additional language:

…but the Company insures that such (mortgage) is subordinate to the lien or charge of the Insured Mortgage upon said estate or interest.

However, if any items which attached to the title subsequent to the original Date of Policy are shown in Schedule B with the foregoing insurance that they are subordinate, the following additional exception must be inserted in Schedule B by the date down endorsement:

Any impairment of the priority or amount of the insured mortgage for the reason that any disbursements made after (the *original date of the policy) were not obligatory or were made in a manner or for purposes not entitled to the benefit of such security with its original priority.*

There may be state specific language that is used for these matters and you should follow the directions of your Company underwriting advisor.

Policy and Commitment Issuance

ALTA Plain English Title Insurance Commitment

THE PLAIN ENGLISH FORM OF THE ALTA COMMITMENT WAS ORIGINALLY ADOPTED BY ALTA IN 1982. THIS FORM WAS DESIGNED TO MEET CRITICISMS OF THE PREVIOUS ALTA COMMITMENT FORM AND TO BE RESPONSIVE TO THE DEMANDS FOR PLAIN LANGUAGE INSTRUMENTS. IT IS INTENDED THAT THIS FORM BE USED WITH ANY FORM OF POLICY THAT MIGHT BE WRITTEN. THE INSURED IS ENTITLED TO RECEIVE A SAMPLE OF THE POLICY FORM (AS OPPOSED TO A PRO FORMA POLICY) IF REQUESTED.

The basic philosophy of the ALTA Forms Committee in the preparation of this commitment is embodied in paragraph 4 of the Conditions which negates the notion of negligence and search liability or that this commitment is a representation of the status of title. The commitment is merely a statement of the type of insurance policy that will be issued and all liability of the Company is to be founded upon the commitment and the policy.

Policy Amount Limitations

THE MAXIMUM AMOUNT FOR WHICH YOU ARE AUTHORIZED TO ISSUE A TITLE POLICY IS SPECIFIED, AS TO AGENCIES, IN THE CONTRACT WITH THE AGENT, AND, AS TO COMPANY OFFICES, BY INDIVIDUAL AUTHORITY LEVELS COMMUNICATED TO YOU BY YOUR COMPANY'S UNDERWRITING ADVISOR OR SUPERVISOR. BEFORE YOU CAN ISSUE, OR COMMIT TO ISSUE, A TITLE POLICY FOR AN AMOUNT IN EXCESS OF YOUR AUTHORIZED AMOUNT, YOU MUST OBTAIN THE APPROVAL OF YOUR COMPANY UNDERWRITING ADVISOR. ***BE AWARE THAT ISSUING MULTIPLE POLICIES IN A SINGLE TRANSACTION, AS DESCRIBED IN THE SINGLE RISK SECTION BELOW, COULD EXPOSE THIS COMPANY TO A LOSS IN EXCESS OF YOUR AUTHORIZED LIMIT EVEN THOUGH NO SINGLE POLICY IN THAT TRANSACTION IS FOR AN AMOUNT GREATER THAN YOUR AUTHORIZED LIMIT.***

You are expected to comply strictly with the prohibition against issuing or committing to issue a title policy for an amount in excess of your authorized amount without first obtaining the approval of your Company underwriting advisor.

You may request this approval as directed by your Company underwriting advisor. Usually this is done by telephone (with written confirmation), fax, e-mail, or pursuant to the Company Policy Approval System, which is web-based. You should state who made the title examination, whether the basis for the examination was the examiner's search of the records, an abstract, or a certificate of title and whether the search and examination was in continuation of a prior title policy, either ours or that of a competitor. The guidelines below provide a general discussion of the types of title issues that should be covered in any request for approval. Your Company underwriting advisor may provide you with a specific form or procedure for you to use, which must be followed before requesting approval. You should specifically direct your Company's underwriting advisor's attention to any situation described in such form or procedure or in your agency contract, or noted below in the guidelines.

Your Company underwriting advisor will give approval either by telephone, fax or e-mail, with written confirmation of telephone approval or disapproval, but may require that material sufficient to permit a reexamination of the title or issues raised be submitted before a decision as to approval is made.

If you have issued a commitment with the requested policy amount unstated, you must obtain the approval of your Company underwriting advisor before you insert an amount in the commitment which is in excess of your authorized amount. If you first become aware that the policy amount will be in excess of your authorized amount at the time you are requested to issue the title policy, you must obtain the approval of your Company underwriting adviser before you issue the policy.

When we have an outstanding policy for an amount which does not exceed your authorized amount and you are requested either to increase the amount of that policy to an amount above your authorized amount, or to reissue the policy for an amount above your authorized amount, you must obtain the approval of your Company underwriting advisor.

Obtaining the approval of your Company underwriting advisor may cause some delay and it can also cause customer anxiety as to whether the approval will be given. The latter is particularly likely in situations where a commitment has been issued without a stated amount, or where a prior policy is outstanding. You can reduce the number of situations where delay or anxiety may be occasioned if you will exercise some judgment at the time the order is placed with you, as to whether it is probable either that the present policy, or a reissue policy within the foreseeable future will be for an amount in excess of your authorized amount. If so, get the approval of your Company underwriting advisor before you issue the first commitment.

Written evidence of the approval is to be retained in the title file.

Single Risk

The single risk limitation is applicable in determining when approval of your Company's underwriting advisor is necessary. If we will be exposed to a loss in excess of your authorized amount because related policies will involve the same risk coming out of a single transaction (for example, the efficacy of resolutions for a corporation deeding out on three policies), you should obtain the approval of your Company's underwriting advisor even though the face amount of each policy will be within your authorized amount.

Examples which are illustrative are listed below, the authorized amount being $100,000:

Type Of Policy And Amount	Approval Of Company Underwriting Advisor Required
1. Owner's Policy for $100,000, simultaneous issue mortgage policy for $75,000	NO
2. Owner's Policy for $100,000, Two (2) simultaneous mortgage policies, one for $75,000, the other for $50,000	YES
3. Three mortgage policies issued simultaneously on first, second and third mortgages, the first being for $75,000, the second for $25,000, and the third for $10,000	YES
4. Owner's Policy for $75,000, simultaneous issue leasehold policy for $50,000	YES
5. Two Owner's Policies, each for $75,000, each covering a specified part of a tract purchased by the insured for $150,000	YES
6. Owner's Policy for $100,000 to builder-subdivider who intends to build 3 houses to cost $50,000 each	NO

GUIDELINES

Extra-hazardous Risk
Does the chain of title or other circumstances present any unusual problem or title insurance risk which you would ordinarily submit to your Company underwriting advisor for approval in cases which are within your authorized limits? See the Authority Parameters Memo issued each year to employees and the discussion of extra hazardous risks found at Risks 3 of this manual.

New Construction
Are you being asked to issue a policy on new construction before construction has been completed? If so, what protection, if any, do you intend that the title policy give as to liens arising from work and material done before the date of the policy and that done after the date of the policy?

Recent Construction
Are you being asked to issue a policy on completed new construction where the statutory period for filing mechanics' and materialmen's' liens has not expired? If so, what protection, if any, do you intend that the title policy give as to such liens for which no record notice appears at the policy date?

Construction Escrow Issues
Are you being asked to disburse funds in installments as new construction progresses? If so, what requirements, if any, are imposed upon you by the depositor of the funds to determine (a) the state of construction, (b) the quality of the construction, or (c) whether the charges for labor and material which have accrued to the date of disbursement have been paid?

Extended Coverage – Survey Issues
Are you being asked to delete, or to fail to insert, our Schedule B exception as to matters of survey? If so, have you been furnished with an adequate survey which reveals, in addition to matters usually shown by such surveys:

(a) underground installations (water pipes, sewers, drain tile, etc.) which might interfere with improvements to be constructed or which underlie improvements already constructed;

(b) encroachments at, above, or beneath the surface;

(c) encroachments over an easement;

(d) violations of building restrictions; or

(e) present improvements or those to be constructed extending over vacated streets or alleys?

Access Issues
Is access to the land over an open, publicly dedicated street? If not, how has a right of access to the land been established?

Subordination/Lien Priority

If you are issuing a loan policy, are you being requested not to show, or to show as inferior, a prior mortgage or other lien represented to be, or which will be made, subordinate to the mortgage insured? If so, how has, or will, the subordination be effectuated?

Contiguity Coverage
Does the title policy which you are issuing include two or more tracts each of which has heretofore had its own separate description? If so, are you being asked to describe all of said tracts by a perimeter description, the effect of which might be to insure that they are contiguous, or to insure contiguity specifically? If so, do both the record title and an adequate survey reflect that there are no gaps or gores between the parcels?

Probate
Is there an unusual will in the chain of title or other unusual aspect to the devolution of a decedent's interest? Is there a probated estate which shows adequate notice to all interested parties? Is there corroboration to unprobated estate information?

Bankruptcy Proceeding
Is title being, or has it been, derived through any proceedings in the bankruptcy court? Is the grantor/mortgagor now subject to the jurisdiction of the bankruptcy court? Is there any evidence that the bankruptcy proceedings, in either of the above situations, may involve additional lands in other areas?

Railroad or Government Grantor in Chain
Has a railroad, or a governmental body, been involved or will it be involved in the chain of title? If so, have you checked:

(a) the deed by which the railroad or body acquired title to determine that it was not just an easement or limited estate which was acquired;

(b) the power of the body to convey or mortgage; and

(c) whether the proper procedure was followed for the conveyance or mortgage?

Partnership
Is there, or will there be, a transaction in the chain of title involving a partnership? If so, and the partnership is a general

partnership, have you ascertained the identity of all the partners and have they all executed the document by which the title is being conveyed or mortgaged? If it is a limited partnership, has that document been executed not only by the general partners but also by all the limited partners, whose identity you have established?

“Shopped Around” Transaction

Do you have any knowledge of any unusual circumstances, rumors, refusal to insure by other companies, or other facts which might create an unusual risk?

Powers of Attorney

THE POWER OF ATTORNEY BEING EXERCISED MUST BE EXPRESSLY AND SPECIFICALLY AUTHORIZED BY A WRITTEN, RECORDABLE INSTRUMENT WHICH IS EFFECTIVE ON THE DATE THE POWER IS EXERCISED BY THE ATTORNEY IN FACT, NOT HAVING BEEN REVOKED OR TERMINATED BY THE PRINCIPAL.

Generally

A person competent to contract may authorize another person competent to contract to act for him in a particular matter or for a special purpose. In a written instrument signed and acknowledged as if it were a conveyance, the principal gives his attorney in fact the authority to act for him. For our purpose, the power to be exercised or the action to be taken must be expressly stated in precise terms. There should be no ambiguity as to the authority given; for example, it has been held that the power to sell land includes neither the power to mortgage nor convey title to the land, nor does it include the power to transfer the title as a gift. The powers to sell, convey, mortgage, make a gift, sign escrow instructions, receive money, waive conditions or accept title on behalf of anyone must be fully stated in the document. Further, the property affected must be identified sufficiently so as to comply with the Statute of Frauds requirements and the power must be in recordable form.

You must be sure that the power of attorney is specific enough to authorize the acts on which we rely to insure title or close the transaction. It is wise to review printed forms carefully. So-called “general” powers of attorney are not adequate for dealing with land interests.

No matter what form of power of attorney is sought to be used, they should be very carefully reviewed when insuring title, or performing settlement services.

Attention should also be given to the evaluation of the authenticity of the power of attorney. If the genuineness of the power arouses our suspicion, a phone call may clarify the matter. There is no reason for shunning telephone communications. We sometimes forget that, with the technological progress of our era, telephone contact may be established with practically every place in the world. We must not be discouraged that the call is made at our expense. It is well worth it to prevent a claim.

Why is a Power of Attorney Being Used?

Each time we are asked to rely on a power of attorney, the question has to be asked: Why is there a need for the power of attorney in the first place? The answer to this simple inquiry may clarify whether we can or cannot rely on the power of attorney. The response might disclose facts that would lead us to require other evidence as to the legal capacity of the grantor.

Execution of Documents by Attorneys in Fact

Any instrument executed by the attorney in fact must be signed in proper form, that is, "John Smith by Henry Brown, his attorney in fact." The acknowledgment on the instrument, however, must be that of the attorney in fact. Any state specific format must be followed.

Powers of Attorney: Past and Present

In the past, when we were presented with an instrument executed under a power of attorney, we insisted on the recording of the power of attorney, and we obtained an affidavit from the principal or the attorney in fact confirming that the power of attorney was effective and in force on the day the power was exercised, having been neither revoked orally or in writing, nor terminated by the principal's incompetency or death. In many jurisdictions, this is yet the practice.

We still insist on the recording of the power, but over the years, some states have either adopted the Uniform Durable Power of Attorney Act or enacted similar legislation which may allow us to rely on the efficacy of the power without an affidavit as to the competency of the grantor. Generally, by statute, the acts of the attorney in fact within the scope of the Durable Power of Attorney during any period of disability, incompetency or incapacity of the principal, bind the principal himself and his successors as if the principal was competent, and third parties dealing with the agent in good faith reliance on a copy of the Durable Power of Attorney are fully protected and released to the same extent as though they had dealt with the principal. Some statutes take a further step to permit third parties to presume that, at the time of their reliance on a Durable Power of Attorney, the principal was alive and the agent's powers had not been terminated. To this extent, state law may permit us to rely on a proper statutory Durable Power of Attorney without making an independent determination that the principal was alive at the time the power was exercised, (unless, of course, we have actual information to the contrary at the time of reliance). However, even with our ability to rely so openly on a statutory Durable Power of Attorney, we need to review them closely as noted above.

When the power of attorney is exercised by an attorney in fact who also has an individual interest in the transaction, consult your Company underwriting advisor. The general rule is that a party in a fiduciary relationship (as an attorney in fact is to the principal) cannot benefit from or be party to a transaction wherein the principal is involved.

Recording of Power of Attorney

As the practice was in the past, these powers of attorney **must be placed of record**. The recording of the power often protects us against unrecorded attempted revocation. Recording also supports the marketability of the title that we insure when we rely on instruments in the chain that are executed by an attorney in fact.

Statutory Limitations

You must check your state laws for limitations which may be imposed on powers of attorney. For example, in at least one state, it is contrary to public policy to use a power of attorney to convey a homestead interest.

Pro Forma Policies

THE REQUEST FOR A "PRO FORMA" POLICY IN A COMMERCIAL TRANSACTION HAS BECOME COMMONPLACE. THIS HAS ALWAYS MEANT TO US A SAMPLE OF A POLICY PROVIDED TO THE CUSTOMER SO THAT THE ACTUAL LANGUAGE AND FORMAT OF THE POLICY THAT WE MAY OR MAY NOT ISSUE IS AVAILABLE TO THEM BEFORE CLOSING.

The Pro Forma Policy is NEVER to be issued in lieu of a commitment. Even if the transaction has been completed before the commitment is issued, the Pro Forma is NOT a substitute for a commitment. There must always be a commitment issued, and that commitment must not include any endorsements or coverages until the proper underwriting (documents and analysis) for the same has been completed.

We have had a number of situations where our customer claimed that the coverages or endorsements included in or attached to a Pro Forma were "promised" or "agreed to".

We cannot become lax in clearly distinguishing the product by which we are committing to insure (commitment or binder), and the product by which we are simply, as a courtesy, providing to the customer sample language which reflects their request for coverage ("Pro Forma").

Over the years there have been many versions of the PRO FORMA "clause" that we include in the sample policy. With the increase in requests to include endorsement samples along with the policy sample, some of those old clauses may not clearly express what we believe is meant, especially in regard to those sample included endorsements.

The proper way to COMMIT to issue additional coverages before the closing, after the underwriter has determined that we are in a position to issue the coverages, is to add a note to Schedule B of the commitment to the effect that "*the policy, when issued, will contain the following endorsements _________as attached hereto*" and then the endorsements may contain the policy/commitment number.

The following is language that has been approved by use for all offices and agents. It is to be used, together with the following rules, when producing sample or specimen policies:

This is a Pro Forma Policy. It does not reflect the present state of the Title and is not a commitment to (i) insure the Title or (ii) issue any of the attached endorsements. Any such commitment must be an express written undertaking on appropriate forms of the Company.

• This should be placed on Schedule A in a prominent location, with or without the term "Note"

• There should be NO Policy Number shown (put "Pro Forma" or "NONE" in the blank)

• There should be NO Amount of Insurance shown (put "Pro Forma" or "NONE" in the blank) If you are requested to add an amount discuss with your Company underwriting advisor

• There should be NO Date of Policy shown (put "Pro Forma" or "NONE" in the blank)

• Each endorsement that may be attached should be marked "Pro Forma Specimen" or "Sample" and NOT SIGNED. Many offices put the word "Sample" or "Specimen" on the signature line, which is acceptable. In addition, no Policy Number should be shown on the endorsement

• The policy cover, if provided, should be marked in a similar fashion.

Railroad Titles

Railroad titles are one of the more nebulous areas which title examiners will encounter. A rail line may appear to be a single continuum many miles long, but often that is not the case. More often, railroad titles are like a patchwork quilt. This is because railroads have obtained their interests in so many different ways. These include direct grants from Congress or the States, use of eminent domain, adverse possession, deeds and other instruments of conveyance which courts have varyingly determined to be fee simple, easements or rights of way.

The term “Right of Way” will frequently be encountered when examining railroad titles. It is a term of art. A right of way is in the nature of an easement but it may have some unique properties depending on how courts in each jurisdiction have defined it. So long as there are tracks with trains running on them, a railroad stands virtually in the same position as a fee simple owner. It can sell (to another railroad), mortgage, lease and license the land. It can control the development of minerals lying under it. But when the trains stop and the track is removed, its rights shrink back to a more easement-like level.

Federal Government Grants

The growth of railroads paralleled the western expansion of the country in the mid-nineteenth century. During this era, Congress gave railroads (or states to in turn give to railroads) land grants as an inducement to build and also pay for the construction of a network of railroads to serve the expansion of the country. The grants were made in two parts: the land upon which the rail line was built (or to be built) and land to pay for the construction of the line. The latter was a grant of land in a checkerboard fashion of alternating sections (initially the even numbered ones, later changed to the odd numbered ones so as not to conflict with grants of school lands, being Section 16 and sometimes Section 36 as well) on either side of the rail line as planned or constructed, being six to twenty miles wide depending largely on the terrain and degree of settlement and as provided in the land grant legislation.

The further west the railroads went, the larger the grants became because of the perceived lack of value (which reduced the amount of money the railroad could raise from its sale; for example, the Union Pacific grant included a provision that the land not sold by the railroad within three years of completion was to be subject to homesteading with a maximum price not to exceed $1.25 per acre). The scope of these grants is staggering. Over 37 million acres of land were granted to the states for railroads and over 94 million acres were granted to the railroads directly. These direct grants are by Act of Congress and are often difficult to find in the local records. For example, Right of Way grants that are 200-500 feet wide are often Federal Grants and must be obtained and examined from the Acts of each Congress or Federal Register.

The idea was that the railroad would not only get land upon which to place the railroad, but also be able to sell the alternating sections to settlers, thus raising enough to pay for the development while the land, or improvements on land used for other purposes than the tracks themselves, could be be assessed and taxed by local authorities. This can result in a very tangled web.

Regulation

In the so-called “Great Age of Railroads,” the volume of their activity became so great that government regulation was imposed. The Interstate Commerce Commission was created at the federal level and similar agencies were formed by the states. Eventually, this regulation became all-encompassing. The Commission would have to decide where the tracks could go, the schedule of service on each line, the rates that could be charged, and whether service could be changed or stopped. Railroads were made a privately owned public utility.

As noted above, the number of railroads and especially the number of miles of track in use has substantially declined. On December 29, 1995, Congress passed Public Law 104-88, which abolished the Interstate Commerce Commission. The commission was replaced by the Surface Transportation Board (“STB”) under the Department of Transportation.

In a number of states, railroad land enjoys a unique status. It may be taxed not locally on a parcel by parcel basis as is other land, but rather on a statewide basis. Often this tax is levied on the combined value of both real and personal property. However, local taxes may be assessed on the interests of licensees or tenants, especially when buildings have been constructed by them. Hence, the existence of coal or lumber yards or similar improvements adjacent to track right of way may be taxed locally even though the right of way is taxed on a statewide basis. One must check the state records in addition to the local records in those jurisdictions for outstanding real estate taxes.

In several states, **railroad land records** are maintained in a central recording system by a state official such as the Secretary of State. Hence, examiners will find very little of record in the county where the land is located. And documents recorded locally, which are not to be ignored for purposes of exceptions, may not be sufficient for purposes of conveyance or constructive notice.

Whereas railroads initially had enjoyed a most favored status, evidenced by the land grants and use of eminent domain, they eventually fell into disfavor. Public opinion was swayed by a number of scandals and courts began to take a closer and perhaps harsher look (both retrospectively and prospectively) at the effect of other documents and proceedings by which the RRs had acquired title. Some states have determined that any land acquired by a RR in eminent domain proceedings could only be an easement (right of way) and not a fee simple, without regard to the terminology used in the instrument. This is may also be true of "Right of Way Deeds" which convey real property "for railroad purposes" or similar scope. Reference in a document to the term "right of way" was found by courts to create a limitation on the quality of title that the railroad obtained.

Similarly, courts looked at eminent domain proceedings in which court appointed commissioners (whose selection was sometimes dictated by the railroad as noted above) authorized the taking of land with a finding that no damages were due because the former owner was benefited by the existence of the railroad. Having taken the land with little or no actual compensation, courts were reluctant to recognize later claims of the railroad to full fee simple title rather than a right of way or easement. The willingness of the railroad to give a "deed" (almost always without warranties) should not be looked at as evidence of title of more than an easement in many states.

In more recent times, railroads have consolidated, shrunk in size and become much less regulated. Our primary focus now relates to the shrinking in size with the resultant abandonment of right of way, with a lesser but still important focus on the consolidations and mergers that have taken place.

Abandonment

Any discussion of regulation must necessarily include some comments about abandonment. The most important point is that the word “abandonment” is a term of art. As such, it has both a technical and a vernacular definition.

In the vernacular, when the railroad ceases to operate a line, it may be said to have abandoned it. However, unless an Order of Abandonment has been issued by the Interstate Commerce Commission (now the Surface Transportation Board), the cessation of use has no legal effect on the right of way. Hence, the attempt of a railroad to sell part of this land or of another to take possession of it under claim of reverter, adverse possession or otherwise, is a nullity until such an Order is entered.

When an abandonment is properly implemented, the railroad may sell or transfer the line to another railroad. This has been the methodology for the creation of the so-called short line railroads that have taken fragments of the interstate lines. Some of the short lines may also operate on an interstate basis. The short lines may not be subject to ICC (STB) regulation, rather coming under state regulation.

Railroads have also removed the tracks, ballast, signal equipment, bridges and other items that may have scrap or resale value. When this occurs, abandonment in the vernacular sense has occurred. When combined with an appropriate Order of Abandonment (state or federal) it was thought that there was a legal abandonment. The result is that, depending on state or federal law, the land **may** revert to the owner of the reversion, be admitted in a “rails to trails” program under federal law or be taken by the state for park or recreation purposes, or be land that the railroad may dispose of as it wishes if it is the fee simple owner.

If there is, in fact, a reversion, the title examiner must determine who is entitled to it. There are at least four possible scenarios.

1. Title may vest in the grantor or the heirs at law or devisees of the grantor and successors.

2. Title may vest in the owner of the adjacent land from which the right of way was taken.

3. Scenario number 2 may result in title going to an owner on one side or the other of the right of way, or

4. it may be split between the two either equally or in proportion to the ownership at the time of the original grant or taking.

Another matter for careful consideration is that railroads have reserved, or attempted to reserve, rights in the land after abandonment. While operating rail lines, railroads frequently gave licenses to other utilities, such as telegraph, telephone, electric, gas, water, sewer and others to use the right of way for their lines for fees, usually annual ones. When the railroads ceased to operate the lines as railroads, the other uses continued and they were reluctant to give up the revenue from these licenses. Now these long, uninterrupted threads of land are even more valuable and in demand for use as ways for fiber optic cable. Hence, they employed a variety of ways to preserve it.

One way was that rather than just walk away from the line, the railroad would contact adjacent owners (whether the holder of the reversion or not) for the purpose of “selling” the right of way to them. The contract and the subsequent deed would reserve the license rights to the railroad. These reserved rights have been recognized by courts. In at least one case, a court found that the reservation allowed the railroad to grant an enlargement of the easement rights even after the railroad had conveyed the right of way to an adjacent owner, describing the interest as a “commercial easement in gross.” In some cases, deeds made by the railroads to the owners of the reversion are legally just a release (full or partial) of the right of way easements. Read any conveyance to and from a Railroad very closely and be sure you are not relying on an abstract or excerpt of the original document,

Adjacent Lands

When the property you are insuring lies adjacent to Railroad property or Right of Way or even near to the same, you need to consider:

- SPUR TRACKS: Are there any spur tracks running into your property? These rights to run a rail line are often not found of record, and the RR maintains ownership of the tracks and equipment, even if the line is not used. An exception should be raised for any indication of rail lines or spurs.

- ACCESS: Does a RR run between our Land and the main mode of access? The right to cross a ROW is very regulated and expensive to build and maintain. Many

RRs run parallel to original state and county roads. In formerly rural areas, the farmer was allowed to cross at points to access their fields, since that was a very sporadic use and public safety did not dictate the need to regulate an agricultural crossing nor did it dictate the need for the train to reduce speed, as they must in more populated areas at grade crossings. Any change in use or development of agricultural lands bounded by a ROW should have careful consideration of the effect on access to the parcels.

We have really just brushed the surface in this consideration of railroad titles. Any request to insure title to property that is or has been part of a railway system or owned by a railroad must be discussed with your Company underwriting advisor.

Restrictive Covenants and Protected Classes

CCRs Based on Race, Color, Religion, Sex, Handicap, Familial Status, National Origin or other protected classes

DO NOT ACCEPT FOR RECORDING, RAISE AS AN EXCEPTION IN SCHEDULE B, OR OTHERWISE MAKE REFERENCE TO ANY RESTRICTIVE COVENANT AFFECTING OWNERSHIP OR USE OF THE LAND EXPRESSLY BASED UPON RACE, COLOR, RELIGION, SEX, HANDICAP, FAMILIAL STATUS OR NATIONAL ORIGIN. DO NOT RELY UPON ANY RECORDED INSTRUMENT CONTAINING SUCH A COVENANT TO GIVE CONSTRUCTIVE NOTICE OR TO EFFECTIVELY TRANSFER PROPERTY. IF SUCH A COVENANT IS PART OF OTHER RESTRICTIVE COVENANTS WHICH ARE VALID AND NEED TO BE EXCEPTED, AMEND YOUR EXCEPTION OF THE INSTRUMENT CONTAINING THERE RESTRICTIVE COVENANTS IN THE MANNER PROVIDED FOR BELOW.

Section 42 USCA 3604 provides, in part, as follows:

> *It shall be unlawful . . . (c) to make, print, or publish, or cause to be made, printed, or published any notice, statement, or advertisement, with respect to the sale or rental of a dwelling that indicates any preference, limitation, or discrimination based on race, color, religion, sex, handicap, familial status, or national origin or an intention to make any such reference, limitation, or discrimination*.

The Department of Justice has interpreted this statute as requiring title insurance companies to refrain from showing or reporting any such restrictive covenant and we comply with this interpretation. Congress has created certain exemptions to some of the above referenced categories. These exemptions are found in 42 USCA 3607, a portion of which is attached as Exhibit A, as is the definition of “familial status” found at 42 USCA 3602(k). To the extent of these exceptions, the covenants may be enforceable. In addition, there may be situations where the covenants and restrictions benefit the handicapped. Therefore, if the instrument contains other proper covenants and restrictions, or covenants and/or restrictions that are exempt or benefit the handicapped, the instrument should be raised as an exception which MUST contain the following language at a minimum:

> Covenants and restrictions recorded in [Book] **_____**, [Page] **_____**, but omitting any covenant or restriction based on race, color, religion, sex, handicap, familial status, or national origin unless and only to the extent that said covenant (a) is exempt under Chapter 42, Section 3607 of the United States Code, or (b) related to handicap but does not discriminate against handicapped persons.

Always verify you are using the proper lead-in language for the state in which the Land is located.

If you are asked to supply a copy of the document, you **MUST** modify the instrument in one of the following manners:

1. Leave a blank where the covenant appears and insert the following in the blank:
   "This covenant omitted."

2. Cross out the covenant.

3. Stamp, type or print across the covenant, or in the margin beside it, these words:

   "This covenant omitted."

4. If the covenant and/or restriction is exempt or benefits handicapped persons, stamp, type or print in the margin beside it the following:

> *"To the extent that this covenant is not exempt under 42 USCA 3607 or discriminates against handicapped persons, it is omitted."*

Mayers v. Ridley, 465 F. 2d 630 provides that any document containing such covenants is illegal to record, and if it did get of record, it would be construed to be illegally recorded and therefore would not give constructive notice. You should not accept any document for recording which violates 42 USCA 3604, nor should you insure any title relying on protection of notice from the record of any instrument containing such covenants filed or recorded after April 11, 1968 (unless we have already insured the title subsequent to the recording or filing). HOWEVER, no exception which would otherwise be made in a title policy should be waived merely on the ground that an instrument does not constitute record notice on the authority of *Mayers v. Ridley.*

Some states have even more comprehensive language in their guidelines for showing exceptions because there may be additional groups protected under state law. You are directed to use the form of excluding language that has been approved for the state in which the Land is located.

YOU MUST COMPLY WITH THE ABOVE STATED DIRECTIVES. NO EXCEPTIONS WILL BE TOLERATED.

Risks

The Nature of Basic Underwriting Risk

THE <u>BASIC UNDERWRITING RISK</u> IS THAT WHICH WE ASSUME WHEN:

A. WE HAVE MADE AN ACCURATE EXAMINATION OF MATTERS APPEARING IN THE PUBLIC RECORDS,

B. ISSUED OUR STANDARD FORMS OF OWNERS OR LOAN POLICY WITHOUT KNOWLEDGE OF ANY MATTER NOT DISCLOSED BY THE PUBLIC RECORDS WHICH WOULD AFFECT THE OWNERSHIP, AND

C. HAVE SHOWN IN SCHEDULE B OUR FIVE GENERAL EXCEPTIONS AND ALL ADVERSE MATTERS DISCLOSED BY THE EXAMINATION WHICH HAVE NOT BEEN ELIMINATED PRIOR TO THE ISSUANCE OF THE POLICY.

IF THE POLICY WHICH IS ISSUED EXTENDS A GREATER COVERAGE THAN THAT DESCRIBED ABOVE, THEN IT IS GIVING EXTENDED OR ADDITIONAL COVERAGE FOR WHICH ADDITIONAL INVESTIGATION AND CONSIDERATION ARE NECESSARY.

Our standard forms of owner’s and loan policies have been prepared so as to except loss arising from matters which are not disclosed by the public records but which are known to the insured and are not known to us, and also as to those matters which are disclosed by the physical condition and occupancy of the land but which are not disclosed by the public records. This is true, however, only if Schedule B of the policy contains the five general exceptions which relate to taxes and assessments, matters of survey, rights of parties in possession, easements and claims of easement and unfiled mechanic’s liens.

The policies, in turn, have been prepared so as to impose liability on us for matters which are disclosed by the public records and for those matters which affect the ownership, even though not disclosed either by the records, by the condition or occupancy of the property or by direct notice or knowledge given to the insured.

When we have issued a policy in which we have accepted only the basic underwriting risks, as above defined, these risks can be categorized as follows:

a. Those which arise because of acceptable non-disclosed risks

b. Those which arise because we may have failed to obtain all of the public record information which affects the land

c. Those which arise because we may have incorrectly evaluated the effect of the record information which we have obtained

d. Those which arise because the policy obligates us to pay the cost of defense of the title which we have insured, even though the attack being defended against is without merit and is successfully defeated

If the policy which we have issued exposes us to risks which fall outside the above categories, then we have given extended or additional coverage and you are required to make additional investigations, follow special procedures and – in many instances – obtain the approval of your Company underwriting advisor before such coverages can be included in the policy.

EXHIBIT A

For your reference, the exemptions found at Section 3607 and the definition of "familial status" found at Section 3602(k) follow:

<u>Section 3607.</u> *Exemption*
(a) Religious organizations and private clubs.

Nothing in this subchapter shall prohibit a religious organization, association, or society, or any nonprofit institution or organization operated, supervised or controlled by or in conjunction with a religious organization, association, or society, from limiting the sale, rental or occupancy of dwellings which it owns or operates for other than a commercial purpose to persons of the same religion, or from giving preference to such persons, unless membership in such religion is restricted on account of race, color, or national origin. Nor shall anything in this subchapter prohibit a private club not in fact open to the public, which as an incident to its primary purpose or purposes provides lodgings which it owns or operates for other than a commercial purpose, from limiting the rental or occupancy of such lodgings to its members or from giving preference to its members.

(b)(1) Nothing in this subchapter limits the applicability of any reasonable local, State, or Federal restrictions regarding the maximum number of occupants permitted to occupy a dwelling. Nor does any provision in this subchapter regarding familial status apply with respect to housing for older persons.

(2) As used in this section, "housing for older persons" means housing -.

(A) provided under any State or Federal program that the Secretary determines is specifically designed and operated to assist elderly persons (as defined in the State or Federal program); or

(B) intended for, solely occupied by, persons 62 years of age or older; or

(C) intended and operated for occupancy by at least one person 55 years of age or older…."

Section 3602

"(k) "Familial status" means one or more individuals (who have not attained the age of 18 years) being domiciled with - -

(1) a parent or another person having legal custody of such individual or individuals; or

(2) the designee of such parent or other person having such custody, with the written permission of such parent or other person.

The protections afforded against discrimination on the basis of familial status shall apply to any person who is pregnant or is in the process of securing legal custody of any individual who has not attained the age of 18 years."

Risks

Non-Disclosed Risks

THE RECORDING SYSTEM, USED IN MOST AREAS IN WHICH WE DO BUSINESS, IS DESIGNED TO PROTECT THE "INNOCENT" PURCHASER OR MORTGAGEE AGAINST LOSS FROM MATTERS WHICH ARE NOT DISCLOSED BY THE PUBLIC RECORDS OR BY THE PHYSICAL CONDITION OR OCCUPANCY OF THE LAND. THERE ARE, HOWEVER, CERTAIN INTERESTS OR RIGHTS AGAINST WHICH SUCH PURCHASERS AND MORTGAGEES ARE NOT PROTECTED. INSURANCE AGAINST THESE INTERESTS OR RIGHTS IS AFFORDED BY OUR STANDARD FORM OF OWNER'S AND LOAN POLICIES AND IS A RISK WHICH WE INTEND TO ASSUME UNLESS WE HAVE REASON TO BELIEVE THAT THERE IS, IN FACT, IN A PARTICULAR CASE, SUCH AN OUTSTANDING INTEREST OR RIGHT.

Examples of some of the interest and rights which will prevail over a purchaser or mortgagee who has no notice or knowledge of such rights are:

- That of an owner, or spouse of an owner, whose signature has been forged to a deed or mortgage
- That of a mortgagee whose signature has been forged to a satisfaction or release of the mortgage
- That of a spouse of an owner who represents himself in a deed or mortgage to be unmarried
- That of an owner who, at the effective date of a deed or mortgage, is under legal disability, such as being a minor or, in some instances, mentally incompetent
- That of an heir of a decedent who is omitted, intentionally or innocently, from the information supplied by others as to the identity of the heirs

These types of risks are sometimes referred to as "pure insurance risks". But the fact that we assume the risk as to such matters when neither we, nor our insured, has any information that one or more of them may exist in a particular case does not eliminate the need for additional investigation to determine whether any do exist in those cases where you are given any reason to believe that one may exist.

Risks

Extra-Hazardous Risks

THE <u>BASIC UNDERWRITING RISK</u> IS THAT WHICH WE ASSUME WHEN:

A. WE HAVE MADE AN ACCURATE EXAMINATION OF MATTERS APPEARING IN THE PUBLIC RECORDS,

B. ISSUED OUR STANDARD FORMS OF OWNER'S OR LOAN POLICY WITHOUT KNOWLEDGE OF ANY MATTER NOT DISCLOSED BY THE PUBLIC RECORDS WHICH WOULD AFFECT OWNERSHIP, AND

C. HAVE SHOWN IN SCHEDULE B OUR FIVE GENERAL EXCEPTIONS AND ALL ADVERSE MATTERS DISCLOSED BY THE EXAMINATION WHICH HAVE NOT BEEN ELIMINATED PRIOR TO THE ISSUANCE OF THE POLICY.

AN <u>EXTRA-HAZARDOUS OR EXTRA-ORDINARY RISK</u> SUBJECTS US TO AN EXPOSURE GREATER THAN THAT WHICH IS DESCRIBED ABOVE AS A BASIC UNDERWRITING RISK. THIS EXPOSURE MAY OCCUR EITHER:

A. BECAUSE OF A FACTUAL SITUATION WHICH AFFECTS THE OWNERSHIP OF, OR THE VALIDITY/ENFORCEABILITY OF, THE MORTGAGE ON THE ESTATE OR INTEREST IN THE LAND WHICH IS BEING INSURED, OR

B. BECAUSE OF ACTS DONE, OR NOT DONE, IN CONNECTION WITH THE ISSUANCE OF A POLICY/COMMITMENT/ ENDORSEMENT, INCLUDING THE ISSUANCE OF ADDITIONAL COVERAGES.

You are not to subject the Company to an exposure which is an extra-hazardous or extra-ordinary risk without strict compliance with published Company procedures which may include the prior approval of your Company's underwriting advisor. Extra-hazardous or extra-ordinary risk may occur because of the circumstances affecting the ownership of, or the validity/enforceability of the lien of the mortgage on the estate or interest being insured, or because of practices involved in the issuance of a title policy/commitment/endorsement or affirmative coverages.

If you have a circumstance, or are requested to do, or not to do, some act which, in your best judgment, may subject us to this greater exposure, and cannot find published Company guidelines, do not proceed without first discussing the case with your Company underwriting advisor.

If the transaction does not make sense to you, consult your advisor.

The following are some frequently recurring situations and practices which may result in a greater exposure and which, consequently, require either your Company underwriting advisor's approval or strict compliance with specific procedures.

This list is not exhaustive. It is to be read in conjunction with all memos, directives, bulletins and other communication now and in the future describing particular risks and the proper response to them in addition to contractual limitations and underwriting authority parameters issued from time to time by the Company.

Policy, Commitment, and Endorsement Issuance

Modifying the provisions of a printed or approved Company form by deletion, alteration or endorsement

Insuring, or committing to insure, on a form not approved for use by the Company for the state in which the land is located or for use generally.

Issuing a letter or memo which interprets a policy, commitment, and/or endorsement

Omitting or deleting a General Exception from Schedule B.

Omitting an undischarged lien or encumbrance from Schedule B because indemnity has been deposited

"Insuring over" a defect or lien without showing the defect or lien in Schedule B and then giving affirmative insurance.

Issuing a policy/commitment:

- without examination of all relevant records,
- at a date later than that covered by all searches
- at a date later than that of the survey or inspection

- without determining whether access can be insured,

- without appropriate Uniform Commercial Code searches on fixtures or crops.

Issuing an endorsement which extends the effective date of a policy/commitment without extending all searches and the date of the survey and inspection to and including the extended date

Issuing a policy when the agent, or authorized signatory, or an immediate relative of either, has an interest in the transaction.

Special Factual or Insuring Situations
Where the described land,

- includes a part of a vacated street or alley;

- was once under water;

- is or once was an island;

- is or once was railroad right of way;

- is by special insuring provisions defined to include specific articles which are located on the land as constituting fixtures;

- is air space;

- constitutes specifically described minerals or mineral rights, water or water rights, trees, or growing crops;

- is a building whose ownership is different than the surface of the land on which it is located;

- includes a casino or riverboat facility;

- includes a building or other improvements, whether constructed as a single project or in several phases, under construction or recently completed;

- is located within the boundaries of a current or former Indian reservation.

Where the ownership is claimed by, or once was claimed by;

- a foreign government;
- an alien;
- a person who, under the law, is unable to effectively contract such as a minor, incompetent, Indian or convict;
- a municipal or other government corporation;
- a corporation which is subject to public regulation such as a railroad or a financial institution;
- an entity whose instruments of transfer, conveyance, alienation or hypothecation are, by law, recorded or filed other than at the customary offices searched at the local level, such as railroads and Indian land records;
- a business trust;
- the trustee in an unrecorded trust;
- a corporation, if the corporation is conveying to, or has conveyed to, an “insider”;
- a partnership, if the deed or mortgage made or to be made by the partnership is not executed by all of the partners;
- a limited partnership, if the deed or mortgage executed or to be executed by the limited partnership is not executed by all of the general partners and consented to by all of the limited partners.
- a limited liability company or partnership, if the deed or mortgage executed or to be executed by the limited liability company or partnership is not executed by all the necessary members pursuant to the operating agreement.

Where our proposed insured or Insured in an owner’s policy is;

- a foreign government;

- an alien;
- a governmental agency;
- the United States of America;
- an Indian tribe or tribal association.

Where the estate or interest being insured is:

- a leasehold estate;
- that of a contract purchaser;
- an easement;
- an option;
- in unsevered minerals, trees, or crops;
- a building or other structure where the remainder of the land is not owned by the insured;
- a mortgage made by a corporation, if the proceeds of the mortgage are to be used to finance the purchase of stock of the corporation;
- a mortgage made by either a general or limited partnership to one of the partners;
- railroad right of way or other similar easement in gross.

If ownership of the estate or interest is based on;

- adverse possession;
- escheat.

Where ownership is derived through:

- a non-judicial foreclosure sale of a deed of trust or mortgage;
- a tax deed;
- a sheriff's deed under an execution sale;

- a federal marshal's deed under an execution sale;
- a sale by the Commissioner of Internal Revenue for unpaid federal taxes;
- a seizure by the state or federal government for violation of criminal laws;
- similar sales made by a public official and not confirmed by a court of record having jurisdiction over the parties;
- a previously uninsured gift deed;
- a deed made in lieu of foreclosure.

Insuring the ownership of vacated streets or alleys without determining that all private easements, as well as the public easements, have been eliminated or do not exist

Eliminating the General Exception as to easements or claims of easements where the land includes land once a street or alley without determining that no public utility lines were installed in that part which once was a street or alley.

Knowledge of a map showing future streets requiring same to be excepted where the state law permits construction in the path of such future streets

Reliance upon a land description which refers to natural monuments which may no longer exist or other monuments which are vague and indefinite, particularly if the land involved is in a mountainous or timber area.

Reliance upon a survey to show the location of a newly constructed building where the survey was made prior to the completion of the building

Omitting our General Exception as to mechanics' liens where structures on the land are under construction or where the construction has recently been completed, or issuing a loan policy where priority has been lost:

- in reliance on indemnity letters, affidavits, the financial stability of the builder, etc.;

- relying either upon prior recording, or date of completion, of the house located on the land when the house is one of a number of houses being built on contiguous lots by the same builder;
- failing to determine that no mechanic's lien will arise from off-site construction, such as grading or paving of streets, installation of sewer or water in streets, etc.;
- relying on a deposit of funds to cover the expected cost of completion.

When restrictive covenants appear to affect the ownership:

- insuring against loss arising from the enforceability of such restrictive covenants, on any basis including changed conditions or numerous violations;
- insuring against loss arising from the violation of the restrictive covenants by a structure to be constructed or under construction.

When a subordination agreement has been recorded, insuring its effectiveness:

- if it is an "automatic" subordination, rather than one which specifically describes the instrument which creates the estate, interest or lien to which the subordination is made;
- without showing in Schedule B the interest or lien which is being subordinated, with appropriate affirmative insurance to the effect that it has been subordinated and describing the subordination agreement;
- if the agreement attempts to subordinate the fee ownership of the land to a mortgage on a leasehold estate.

If the land abuts on, is covered by or once was covered by, water:

- insuring the ownership of that part of the land which has been accreted;

- insuring the ownership of land covered by water without excepting the rights of the public and upper and lower riparian owners to use the water;

- insuring land once covered by water without exception as to the right of the federal navigation servitude;

- insuring land abutting water where the boundary may frequently shift due to the action of the water.

Insuring the ownership of an easement in gross

Insuring the assignment of a beneficial interest in trust deeds

When the chain of title discloses a substitution of a deed of trust trustee and reconveyance by such substituted trustee

Issuing an owner's policy in a "sale-leaseback" transaction if:

- there is an option granted to, or an obligation imposed on, the lessee to repurchase the land;

- there is any indication in the documents that the parties consider the sale-leaseback to be mortgage transaction.

Issuing a mortgage policy which by endorsement or otherwise insures the validity of an assignment being made as a part of an asset "swap".

Additional Coverages

Issuing any endorsements which give additional coverages, including, but not limited to, endorsements which give additional coverages with respect to the following matters:

Usury
Non-Imputation
Recharacterization Issues
Shared Appreciation
Additional Interest
Cash Flow
Clogging the Equity of Redemption
Creditors' Rights
Synthetic Leases/Off balance Sheet Financing
Shopping Center Endorsements

Zoning
“Fairway” or Successor Insured Coverage
First Loss
Last Dollar
Maximum Actual Loss
Survey Matters
Assignment of Policy
Inflation
Third Party Insured
Letter of Credit
Collateral Assignment of Mortgage
Revolving Credit
Future Advance
Incoming Partner
Option to Purchase
Co-insurance Clauses
Future Insurance
Spreader/Tie-in/Aggregation
Abutting Street/Access
Tax Foreclosure
Utility Facility
Doing Business
Anti-taint
Enforcement of Severed Mineral Rights
Covenants Running With the Land (CLTA 124.1)
Co-insurance policies/”me too” endorsements
Leasehold
Tax Credit Benefit
Excess insurance
Manufactured Housing
Private Rights
Mortgage Modifications
Interest rate Swaps
Minerals
Severed Improvements
Energy Projects
Mezzanine Financing

REMEMBER TO CHECK ALL CURRENT COMMUNICATIONS FROM THE COMPANY CONCERNING THE UNDERWRITING OF ANY ORDINARY AND EXTRA ORDINARY RISKS, INCLUDING THE GUIDELINES CONTAINED IN THE CURRENT ENDORSEMENT MANUAL

Short Sales

A "SHORT SALE" IS A TRANSACTION WHERE THE SALES PROCEEDS ARE NOT SUFFICIENT TO COVER THE OUTSTANDING MORTGAGE DEBT. A SHORT SALE (ALSO KNOWN AS A "SHORT PAY TRANSACTION") CAN BE COMPLEX AND MAY POSE A HIGHER RISK TO CLOSERS OR SETTLEMENT AGENTS, AND TITLE INSURERS.

A short payoff letter or estoppel ("short pay approval") differs from a full payoff letter or estoppel; it is the lender's acceptance of less than what is currently owed. A short pay approval is typically addressed to the borrower of the existing loan (the "seller/borrower" for purposes of this memo) as it is considered a contractual agreement between the lender and its borrower. The short pay will only be accepted by the lender if the seller/borrower accepts the terms and conditions contained in the short pay approval.

Although it is most common to see a short pay in conjunction with the sale of the subject property, some lenders will accept a short payoff in a refinance of the subject property. Therefore, the content of this section will refer to a short pay in either circumstance.

The Company has been advised that both direct offices and agents have received short pay approval letters on short pay transactions that contain language which includes unacceptable requirements or conditions. Conditions which would allow a lender *at any time* to refuse to release a mortgage *after* it has received pay-off funds pursuant to that letter are **not** acceptable and may not be relied upon by offices and agents.

This is an excellent example of the reason why a short pay approval letter must be read by the settlement agent just as closely as the closing instructions themselves to make sure we understand all instructions, including any conditions or limitations that the payoff lender may include in connection to the release or reconveyance of their mortgage or deed of trust. Particularly in the case of short sales, the settlement agent must carefully read every document submitted by the short pay lender in connection with the payoff of an existing lien. In addition, the short pay approval may require additional documents to be signed by the seller/borrower or new buyer. Some of these documents include:

- Unsecured Promissory Notes executed by the seller/borrower back to the short pay lender
- Assignment of unearned insurance premium refund from seller/borrower to short pay lender
- No proceeds to seller/borrower or junior lien holders
- An accurate HUD 1 to be faxed to the short pay lender, before closing.

Some examples of problem language in a short pay approval include:

"[Lender] has the unlimited right to revoke this short payoff approval within 30 days of receiving purchase documents"

"*If the property was acquired by means of fraud, [Lender] reserves the right to pursue any and all actions available to it to offset its losses. If it is determined that Seller(s) and /or Buyer(s) participated in any way to the fraud, this short sale will be void, and the Note and Security Instrument will remain in full force and effect."*

You are hereby instructed that you are not authorized to close any transaction in which you have received an estoppel or payoff letter or other document in which any type of conditional language appears without approval from your Company underwriting advisor.

Any such conditional language must be removed. The only exception that has been agreed to is when a Countrywide Mortgage short pay approval letters contains the following condition:

"There are to be no transfers of property within 30 days of the closing of this transaction"

If this is the entire condition (older versions contained an additional sentence which is unacceptable) the settlement agent is directed to:

1. Obtain the buyer's signed acknowledgment and hold harmless that the buyer will not be transferring the property within a 30 day period, and will be occupying the premises as buyer's principal residence, and

2. Insert the following exception into the buyer's Owners Policy (not the new Loan Policy):

> "*The transaction vesting the Title as shown in Schedule A being subject to a condition prohibiting the transfer of the Title within 30 days after Date of Policy, as disclosed to the Company in writing.*"

Settlement agents who receive a short pay approval letter containing any conditional language are reminded that the negotiation of the terms of the short pay is the responsibility of the seller/borrower and/or their agent, and not the duty of the settlement agent. An approval letter containing conditional language should be returned to the seller and/or their agent explaining the title company is unable to close or insure based on the conditional language. If the conditional language is removed and there are no other issues outstanding, the transaction may be closed.

As illustrated above, short pay transactions create an entire set of new issues for closers or settlement agents. Settlement agents who receive a short pay approval letter with any kind of conditional language and are not sure whether the language is acceptable are encouraged to contact their Company underwriting advisor to discuss the matter.

Subordination Agreements

A PRIOR INTEREST IN LAND MAY BE MADE SUBORDINATE (INFERIOR) TO ANOTHER INTEREST BY THE ACT OF THE OWNER OF THE PRIOR INTEREST.

FOLLOW THE PROCEDURES HEREAFTER SET FORTH IN DETERMINING WHETHER THE VALIDITY OF THE SUBORDINATION CAN BE INSURED, AND THE MANNER IN WHICH SUCH INSURANCE SHOULD BE SHOWN IN THE TITLE POLICY.

Interests Which Are Frequently Made Subordinate

1. A prior lien, such as a mortgage, judgment, mechanics' or federal tax lien to the lien of a subsequent mortgage.

2. A prior lease or tenancy right to the lien of a subsequent mortgage.

3. The rights of a contract purchaser to the lien of a subsequent mortgage.

4. The ownership of the fee to a mortgage lien on a leasehold estate. (This should not be called a "subordination." See discussion at 3.a. below).

The Manner In Which A Subordination Is Accomplished

1. A written instrument executed by the current owner of the interest created by the prior instrument at the time of, or after, the creation of the interest which is to be given priority and which specifically describes that interest, must be recorded.

(a) If the prior interest is a mortgage, you should consider whether, under your state laws, the note or bond secured by the mortgage should be marked by the recorder to show that a subordination has been recorded in the same fashion that the note is marked to show that a partial release of a part of the security has been recorded.

2. Do not rely upon an "automatic" subordination, that is, a provision in the instrument creating the prior interest

which states that it will become subordinate to a later interest as soon as that interest is created, without the approval of your Company underwriting advisor.

(a) This provision is used frequently when the prior interest is either a lease or a purchase money mortgage and the later interest is a construction mortgage.

(b) Much litigation has occurred when the construction mortgagee has asserted that the prior interest has been eliminated by the foreclosure of the construction mortgage with the courts holding, in many instances, that;

(1) if the automatic subordination provision is broadly drafted, it is too indefinite to be enforced, or

(2) if the provision attempts to specify the exact terms of the construction mortgage, the construction mortgage actually given does not meet those specifications and therefore the prior interest is not subordinated.

3. Do not rely upon either an "automatic" subordination provision in a lease or a subordination agreement executed at the time of the execution of a leasehold mortgage to subject the fee ownership of the land to the lien of the leasehold mortgage, without the approval of your Company underwriting advisor.

(a) The fee ownership should be **subjected** to the lien of the leasehold mortgage either by the fee owner joining in the execution of the mortgage, even though the fee owner may not incur any personal liability for the payment of the debt, or by the execution by the fee owner of a mortgage to further secure the payment of the debt secured by the leasehold mortgage: Stated simply: the fee owner mortgages his interest, he does not "subordinate" it to the lien of a mortgage.

Showing The Subordinate Interest In The Policy

1. You must show the interest which has been subordinated as a Schedule B exception in the loan policy which you are issuing, since the subordinated interest is still a lien or encumbrance on the mortgagor's interest on the date of the loan policy. See SECTION POLICY AND COMMITMENT ISSUANCE 8 - INSURING OVER GENERAL OR SPECIAL EXCEPTIONS.

2. If you are satisfied that the subordination agreement has made the interest affected by it inferior to the lien of the mortgage which is being insured, the loan policy should so insure.

(a) If you are using a Schedule B form which has PART II the insuring language is contained in the printed paragraph immediately following PART II; show, therefore, both the interest which has been made subordinate and the instrument by which it has been made subordinate substantially as follows:

> [*Mortgage, lease, contract] filed for record on ____ as Document No. ___ which states that it is subordinate to the lien of the Insured Mortgage by the instrument filed for record on _____ as Document No. _____*

(b) If you are using a Schedule B for which does not have PART II, show the exception for the interest which has been made subordinate substantially as follows:

> [*Mortgage, lease, contract] filed for record on ___ as Document No.__*
>
> *NOTE: The Company insures against loss or damage sustained in the event that the foregoing ___[mortgage, lease, contract] is not subordinate to the lien of the Insured Mortgage by the terms of the instrument filed for record on ____ as Document No. _____*

Subordination and Non-Disturbance Agreements

When insuring commercially leased properties, we are often requested by lender's counsel to show Subordination and Non-Disturbance Agreements (hereafter referred to as "SNDA") made between the lender and one or more tenants, sometimes joined in by the borrower/lessor, only in Schedule B, Part II. That is the part of the policy where exceptions to title are shown which are subordinate to the lien of the mortgage insured.

In making such requests, lender's counsel points to the language in the SNDA whereby the tenant agrees to continue paying rent to the lender or the successors of the lender who assumes the position of the landlord/borrower after a foreclosure or deed in lieu of foreclosure. That is to say, they agree to recognize the lender and successors as the landlord and continue to pay rent to that party (attornment). This is especially important in those jurisdictions in which the foreclosure or deed in lieu would result in a termination of the lease, thus allowing the tenant to surrender possession and cease rental payments. Where vacancy rates are high, this is especially advantageous to the lender or its successors.

However, most of these agreements contain a quid pro quo. That is the agreement by the lender not to terminate the lease, i.e., non-disturbance. When vacancy rates are low, market rents may be higher and the lender would then prefer to raise the rent or to terminate the lease, cause the tenant to vacate the space and rent to new tenants at a higher rent. The non-disturbance portion of the agreement acts as a restriction on the rights of the insured lender.

Another risk of which we must be aware is coverage given to the lender or a new buyer in a new owner's policy. We must remember to show the lease as an exception to the new owner's title. There may be resistance by counsel who argue that by showing the SNDA as subordinate in the loan policy, we have agreed to not show it in the new owner's policy. That is **not** the case. It illustrates the difference between coverage under the loan policy and that of an owner's policy. If we do not show the lease as an exception in the owner's policy, we are at peril if the Insured becomes dissatisfied with the tenant and tries to terminate the lease or re-negotiate its terms. When the tenant responds by citing the non-disturbance provisions of the SNDA, the Insured will likely file a claim with us. Our ability to enforce the Exclusion is much less certain at that point.

Basis For Coverage

Where we agree to the lender's request to only show the SNDA in Schedule B, Part II, we do so in reliance upon Exclusion 3(a): "Defects, liens, encumbrances, adverse claims or other matters created, suffered, assumed or agreed to by the insured claimant." As a party to the SNDA, the lender has put itself within this definition. "Insured claimant" includes the lender and any assignee or other successor in interest, such as a related entity that takes title through a deed in lieu of foreclosure and even a purchaser at a foreclosure sale. Discovery would likely disclose that any bidder would have reviewed all leases and related documentation in order to determine the value of the property in making a bid or an offer of purchase.

However, this does place a burden on us to make proof of their agreement and/or knowledge. In the context of a claim, this may prove to be difficult.

Policy Language

One solution that has been successfully used at the outset of the loan transaction is to use amended language for the lead into Schedule B, Part II. The standard language is as follows:

In addition to the matters set forth in Part I of this Schedule, the Title is subject to the following matters, and the Company insures against loss or damage sustained in the event that they are not subordinate to the lien of the Insured Mortgage:

Here is the amended language which we have successfully used on numerous occasions:

In addition to the matters set forth in Part I of this Schedule, the Title is subject to the following matters, but the Company insures against loss or damage sustained in the event that they are not subordinate to the lien of the Insured Mortgage however, said insurance that the following matters are subordinate is subject to the obligations of the Insured under the terms and conditions of any Subordination, Non-disturbance and Attornment Agreements, if any, which may be noted:

Another shorter version is as follows:

In addition to the matters set forth in Part I of this Schedule, the Title is subject to the following matters, and the Company insures against loss or damage sustained in the event that they are not subordinate to the lien of the Insured Mortgage; provided, however, that such insurance is subject to the obligations of the Insured under the terms and conditions of any Subordination, Non-disturbance and Attornment Agreement, if any, which may be noted.

It should be noted that our ability to use this alternate language may be subject to local laws and regulations relating to the filing of forms and the use of language which varies from the filing.

Where we are unable to accede to the request of lender's counsel, we may show the SNDA in Schedule B, Part II, but also raise an exception in Schedule B, Part I as to the obligations of the lender under the SNDA. Should you have any doubt as to which format to use, or in the event that counsel for the Insured requests a deviation, consult your Company underwriting advisor.

UCCPlus Uniform Commercial Code Insurance Policy

General Provisions

A CUSTOMER MAY REQUEST THE INSURANCE OF AN INTEREST THAT IS NOT CONSIDERED REAL PROPERTY, AND THEREFORE WE ARE NOT ABLE TO ACCOMODATE THAT REQUEST BY USE OF OUR TITLE POLICIES. WE MAY BE ABLE TO OFFER A UCCPLUS POLICY DEPENDING UPON LOCATION, PARTIES TO THE TRANSACTION AND TYPE OF INTEREST. YOU ARE DIRECTED TO THE WEBSITE www.uccplus.com FOR ADDITIONAL INFORMATION ON HOW TO CONTACT THAT OPERATION AND ON THE SERVICES THEY PROVIDE. THE FOLLOWING IS A GENERAL DISCUSSION OF THE PRODUCT AND IS NOT TO BE CONSIDERED DETERMINATIVE OF COVERAGE UNDER SUCH POLICY.

The UCCPlus Policy is used to insure a lender's first priority and properly perfected security in personal property collateral, as defined in Article 9 of the Uniform Commercial Code. If a lender is making a loan secured by an entity's accounts, inventory and equipment, for example, the lender would want to obtain a UCCPlus Policy to insure its first priority security interest just in the same way a lender making a loan and securing a promissory note with a mortgage obtains a title insurance loan policy.

General – Basic Coverage of UCCPlus Policies
The UCCPlus Policy insures the Attachment (enforceability as against the Debtor) of that security interest.

Because there is no public registry that enables a lender ("Secured Party") to determine the ownership of the types of Collateral that may be insured under a UCC policy, be they goods or general intangibles for example, the UCCPlus policy does not replace the lender's collateral audit or other due diligence inquiries. As a result, unlike the ALTA lender's policy, the UCCPlus Policy does not insure ownership *per se*. In general, a person pledging property (the "Debtor") may have limited rights in Collateral. These limited rights may be pledged to a Secured Party, and a security interest will attach to the rights as pledged. If the lender wishes to determine that the Debtor owns goods said to be in a warehouse, for example, it must ascertain the Debtor's ownership and the existence and location of the goods for itself.

In certain instances, such as turbines purchased directly from the manufacturer, or membership rights in a business organization in the context of a real estate mezzanine loan, it is likely or possible that the insurer's internal underwriting requirements will include verification of ownership and, in these cases, the UCCPlus Policy will insure ownership of the collateral for the purpose of the Secured Party's lien attaching to the collateral.

Policy Coverage:

(1) The UCCPlus Policy covers "Attachment" of the security interest to the Collateral. For Attachment to take place, the Debtor must either own the Collateral or have rights in the Collateral or the power to transfer rights in the Collateral to a Secured Party. For example, consignees (persons to whom goods are consigned) are able to transfer a security interest to the Secured Party. Such a security interest will "Attach," despite the fact that such consignees do not own the consigned goods. Thus, in every case in which the Debtor owns the Collateral there will necessarily be Attachment; but in some instances Attachment will occur despite the fact that the Debtor has a lesser interest than ownership. Attachment is a prerequisite to Perfection and Priority.

The term "Attachment" necessarily means that the grant of the security interest was validly executed by an authorized person. Thus, the UCCPlus Policy, by insuring Attachment, covers against forgery, fraud, undue influence, duress, incompetency, lack of authority, incapacity, or impersonation, whether or not such risks are expressly addressed in the UCCPlus policy. In this context, obtaining a UCCPlus Policy is the only available means that a lender can get insurance coverage over fraud and forgery in a commercial business loan transaction.

(2) The UCCPlus Policy covers "Perfection" of the security interest. This means that the security interest is enforceable, not only against the Debtor, but also in the bankruptcy of the Debtor and in contests with other secured parties.

Under the UCC, there are four methods of Perfecting a security interest in personal property. They are: (1) automatic Perfection (i.e., the Secured Party need do nothing; Perfection occurs at the moment of Attachment); (2) possession of tangible Collateral; (3) filing of a financing statement in the office of the

Secretary of State (or, for certain real property related interests, in the filing office where a mortgage would be recorded); and (4) "control." "Control" is a requirement that may be satisfied by an agreement between the Debtor, the Secured Party, and another person on whose books the asset is carried that the Secured Party's instructions concerning disposition of the Collateral will be honored.

The UCCPlus Policy does not insure against Perfection in any other manner. Therefore, if Collateral is subject to a law requiring that Perfection be achieved by filing in a central registry maintained by the U.S. government, for example, the UCCPlus policy does not cover Perfection in that Collateral.

The Perfection coverage insures that a subsequent Secured Party or a purchaser of the Collateral will take subject to the security interest, even if its interest is acquired after the date of the policy. Because Article 9 contains rules applicable to specific types of Collateral that permit some types of purchasers to cut off even a Perfected security interest, the policy contains exceptions that generally parallel those rules (see discussion below).

<u>(3) The UCCPlus Policy covers "Priority" of the Security Interest.</u> This means that the insured security interest comes ahead of other security interests that may also be Perfected. As in the case of Perfection, this coverage applies to a competing party acquiring its interest after date of policy.

(4) <u>Security Interest Exists.</u> The UCCPlus Policy logically covers that a Security Interest exists between the secured party and the debtor

<u>(5) Continuity of Coverage.</u> The UCCPlus Policy continues in force after a loan is transferred and inures to the benefit of a transferee other than a guarantor or other person who has provided credit enhancement for the loan.

<u>(6) Coverage under prior and Revised Article 9.</u> Many insured transactions are new transactions or transactions in which the Debtor organization is newly formed, and therefore do not involve the application of former Article 9. However, there is no reason why a transaction entered into before the effective date of Revised Article 9 could not be reviewed and underwritten. Insuring such a transaction would necessarily invoke both Revised and former Article 9. If, for example, a mezzanine financing transaction was entered into prior to the effective date of Revised Article 9, and had been Perfected by delivery of a certificated Article 8 security representing a membership interest

in the entity owning the real property, the security interest was Perfected under former Article 9 and remains Perfected under Revised Article 9. Thus, insuring a pre-effective date transaction necessarily provides coverage under both prior and Revised Article 9, whether or not the policy contains explicit references to former Article 9.

Exclusions from Coverage:

(1) Acts of the Insured. Like many other types of insurance, the UCCPlus Policy excludes loss or damage resulting from defects created, suffered, assumed, or agreed to by the Insured.

(2) Events occurring after Date of Policy: The UCCPlus Policy speaks as of its date (generally, the date of the closing of the transaction to which it relates). Therefore, it does not cover changes in the law arising thereafter, or changes in the facts or documents that were disclosed to the company during the underwriting process prior to the date of policy.

(3) Certain bankruptcy-specific claims. The UCCPlus Policy excludes claims arising from the context in which the transaction takes place (i.e., claims of equitable subordination, fraudulent conveyance, or fraudulent transfer). However, the policy insures and defends against challenges to the extent, validity, or Priority of the security interest brought in the context of a bankruptcy proceeding.

(4) Failure to Perfect by the best available method. Often the UCC permits Perfection by more than one method with respect to a specific type of Collateral. For example, it is permissible to file against a certificated security; it is also permissible to take possession of the certificate. In such cases, the UCC will specify which Perfected Secured Party will have Priority. In this example, it is the Secured Party who obtains possession. The UCCPlus Policy insures Perfection but not Priority of security interests Perfected only by filing in instances in which filing will not confer priority. Secured parties and their counsel are aware of the Perfection method that will confer priority with respect to each Collateral type.

(5) Parties protected by cut-off rules. Sometimes the UCC permits even a Perfected security interest to be extinguished as a matter of law by a transaction between the Debtor and a third party. These rules are called “cut-off rules.” For example, a security interest in goods may be cut-off by a buyer in the ordinary course of business. Additionally, a security interest in a deposit account may be cut-off if the Debtor issues a check to

an innocent person. The UCCPlus Policy excludes the interests of these persons.

(6) Proceeds. The UCCPlus Policy provides only limited coverage for proceeds, but does continue to cover "identifiable" cash proceeds (i.e., cash proceeds which, although commingled with other funds, can be traced under rules established outside of the UCC). One frequently utilized method is the so-called "lowest intermediate balance" rule.

(7) Purchase Money Security Interests. A purchase money security interest in goods will prevail over another Perfected security interest if Perfection is achieved within 20 days after delivery of the goods to the Debtor. Therefore, the UCCPlus Policy does not insure the Priority of the insured lien as against such interests.

(8) Tax Liens. Tax liens are excluded from the UCCPlus Policy. These liens need not be filed under the exact legal name of the Debtor, and, as a practical matter, may be difficult or impossible for the underwriter to discover.

(6) Invalidating Laws and Regulations. The UCCPlus Policy does not insure against usury, truth-in-lending, and consumer protection laws, as they do not affect Attachment, Perfection, and Priority, but only limit or foreclose a remedy to which the insured would otherwise be entitled.

Prevailing Law

The UCCPlus Policy form employs a number of terms not in general use. These terms have the definitions or meanings ascribed to them in the Uniform Commercial Code (the "UCC"). Note that in looking at the UCCPlus Policy, if a term is defined or used in Article 9 of the UCC in different manner than it is defined or used elsewhere in the UCC, it is intended that the Article 9 meaning shall be definitive. Most states generally follow the uniform version recommended for promulgation by the National Conference of Commissioners on Uniform State Laws and the American Law Institute.

Transfer Fee Covenants

THIS SECTION SETS FORTH GUIDELINES FOR TRANSACTIONS INVOLVING PROPERTY WHICH IS ENCUMBERED BY A TRANSFER FEE COVENANT**.**

A “transfer fee” covenant is designed to run with the land and require subsequent sellers or buyers to pay a “transfer fee” of a specified percentage (usually one percent (1%)) of the consideration to be paid on the sale of the property to the covenantor or a trustee representing the covenantor and/or others. This is also called a “private transfer tax” among other things. When you encounter property in which such a covenant is involved (either previously recorded or to be recorded as part of the insured transaction) the following guidelines must be followed:

1. All title policies and commitments must contain the following exception:

Covenants, conditions and restrictions and other instruments recorded in the public records purporting to impose a transfer fee or conveyance fee payable upon the conveyance of a interest in real property or payable for the right to make or accept such a transfer, and any and all fees, liens or charges, whether recorded or unrecorded, if any, currently due and payable or that will become due or payable, and any other rights deriving therefrom, that are assessed pursuant thereto.

Note: If you have the specific recording information for a recorded covenant, it should be substituted in the exception for the general reference to “public records.”

2. The Covenant must be disclosed to the proposed insureds on the form as shown below.

If the document is to be recorded with the current transaction, the new lender must authorize this. They are not acceptable to most lenders or governmental insurers. The majority of states have already passed statutes that deem such covenants void and California has passed a statute requiring specific disclosure of its existence. If you are in one of these states you must comply with your local law. If you have questions contact your Company underwriting advisor.

PRIVATE TRANSFER FEE DISCLOSURE

1. The property which you are buying is encumbered by a covenant which requires payment by the seller of a transfer fee upon any transfer of the property. This fee is not imposed by any governmental entity.

2. The amount of the fee is ____percent (_%) of the consideration paid for the transfer or $__________ [*or other amounts as described in the document*] and will be charged to the Seller. Any change in the Sales Prices will affect the fee owed by the Seller.

3. Failure to pay the fee will result in a lien on the Buyers' property.

4. Upon the Buyers' sale of the property in the future this fee will be charged again based upon the price at which the property is being sold and will have to be paid by Buyer.

5. The fee will be paid to the following entity(ies) or person(s): ________________________________.

6. The terms of the covenant will not expire until the following date: ___________________.

7. Any title insurance policy issued on this property will have an exception for the covenant and any lien resulting from the covenant.

8. If you have questions concerning this fee you should consult an attorney.

Seller certifies that the information herein is true and correct.

Seller ____________________________ Date _________
Seller ____________________________ Date _________

Buyer certifies that the covenant and related fee have been disclosed to Buyer and that Buyers title policy will contain an exception for the covenant and fee.

Buyer ______________________________ Date _________
Buyer ______________________________Date _________