



Notre Dame Law Review

Volume 5 | Issue 5

Article 1

2-1-1930

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Recommended Citation

M. M. Oshe, *Title Insurance As Protection to Investors in Real Estate and Real Estate Securities*, 5 Notre Dame L. Rev. 237 (1930).

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The NOTRE DAME LAWYER

A Monthly Law Review

"Law is the perfection of human reason"

VOLUME V

FEBRUARY, 1930

NUMBER 5

Title Insurance as Protection to Investors in Real Estate and Real Estate Securities

By HON. M. M. OSHE

The investor of money, who is interested in ascertaining how Title Insurance protects him can obtain no better understanding of the subject than by a comparison of Title Insurance with other systems of title protection, such as the lawyers' opinions of title, and the guaranteed certificate of title. In the course of such a comparative study the extent of the protection which Title Insurance affords to investors in real estate securities will become amply apparent and its superiority over any other system of protection will, I believe, be easily demonstrable.

In early days when titles were simple, and lawyers too, opinions of title were made by the lawyers based on searches which they personally made of the records. In those days there were no abstracts at all and it was when titles became more elaborate, so that searching became onerous, that the system of abstracting the records was developed. This was almost immediately taken up as an enterprise distinct in itself and entirely separate from the business of examining a title and giving an opinion thereon. This business, of course, was usually done by persons or firms organized for that purpose only, whose sole business then was to compile abstracts showing the condition of the title. This abstract was then examined by a lawyer, who rendered his opinion based thereon. This system I shall hereafter call the abstract-lawyer's opinion system. Sometimes abstract companies went into the business of examining the title and issuing certificates of title, which correspond to a lawyer's opinion of title. Others guaranteed the

correctness of their opinions of title which were known as guaranteed certificates of title. The final step in this process of evolution is the guaranty policy or title insurance policy. This first came into use in Philadelphia in 1876, since which time the business has spread all over the country and there are now many companies engaged in the title insurance business. The commencement of this business everywhere met with very strenuous opposition from the lawyers, because, of course, it meant the substantial elimination of one fairly lucrative branch of their business, namely, examining abstracts and rendering opinions of title. The financial interest, particularly the insurance companies who have millions to invest in real estate mortgages, were ready for the step, having at once recognized the great advantages of Title Insurance and having grown weary, no doubt, of the cumbersome abstract-lawyer's opinion system. That the institution of the Title Insurance system in this country was a step forward, is best attested by the growth of the business throughout the country, and particularly in the large cities.

The abstract-lawyer's opinion system is still in quite general use all over the country, except in some of our large cities, so let us examine it also with a view of what protection it affords the owner of property or the holder of a real estate mortgage. Under this method a purchaser of a title buys a title subject to two sources of error. First, the errors in the abstract itself, and secondly, the errors of the attorney who examines the abstract. If the loss is due to an error by the attorney, this gives rise to an action against the attorney who will be liable for the loss only in the event of negligence or want of ordinary skill and knowledge. Both of these remedies are difficult to obtain, as everybody knows, and especially a remedy which is predicated upon showing a want of skill and requisite knowledge to examine an abstract.

So that if an attorney examining an abstract is confronted with the construction of a deed or will, and his opinion is wrong, what court will charge him with gross negligence, especially in this country where the judge himself may be practicing law again after the next election?

Another phase of the method is this: No lawyer wants to be sued for negligence in examining an abstract, and consequently for his own protection he raises all the questions he knows how to raise, making it necessary for the seller to demonstrate beyond all reasonable doubt the goodness of his title. And still another feature of this method is that one lawyer knows more or less than another about titles, depending upon what night law school he attended, so that if a title is transferred three or four times a year, as happened frequently during the past few years of unusual real estate activity, and the abstract is examined by many different lawyers, the second lawyer on the second examination raises more objections than did the lawyer who first examined it, and the third one raises more objections, so that the confusion which results is often very embarrassing, not to speak of the loss of time involved in the process. Then again each lawyer charges a fee for each examination of the title, so that an unnecessary waste of money and time is added to the inadequacy of the protection afforded by this system.

Now let us examine a guaranteed certificate of title and see how it protects the owner of property or the investor in real estate securities, who rely upon it. First, it must be borne in mind that a guaranteed certificate does not guarantee the title. It is simply a guarantee that the certificate is correct. This guarantee is practically a warranty, and any error in the certificate constitutes a breach of contract, and gives rise to an action for loss and damages. The breach of contract, under a guaranteed certificate, occurs at the time of the delivery of the certificate, for if it is erroneous, it is erroneous when issued, and consequently the statute of limitations begins to run from the time the certificate is delivered. To emphasize this point, let me illustrate it in this way: Suppose there is a two-year limitation against actions on such certificates, and an error is discovered after two years, which results in loss to the holder of the certificate. He cannot recover on the certificate. Another deficiency in the guaranteed certificate is that since it is not a contract to indemnify against loss, only one cause of action can be brought on the certificate. Therefore, if there should happen to be several losses in connection with a title pur-

chased in reliance upon a guaranteed certificate, no recovery could be had upon the successive losses. For instance, there are two errors in the certificate. The first is discovered soon after the certificate is delivered, and suit is brought and the loss is recovered in such suit. Then another error is discovered also causing a loss to the holder of the certificate. No action will lie for this loss. These things, I think, prove the insufficiency of a guaranteed certificate of title.

Now I am coming to a title insurance policy, and at the outset I will refer you the most complete judicial definition I have found of such a contract from the case of *Foehrenbach vs. German-American Title and Trust Company*, 217 Pa. St. 331:

“Title insurance is not mere guesswork, nor is it a wager. It is based upon careful examination of the muniments of title and the exercise of judgment by skilled conveyancers. The quality of a title is a matter of opinion as to which even men learned in the law of real estate may differ. A policy of title insurance means the opinion of the company which issued it, as to the validity of the title, backed by an agreement to make that opinion good in case it should prove to be mistaken and loss should result in consequence to the insured. It must be borne in mind that the real subject of insurance is not the concrete thing, but the interest which the one to be indemnified has in the concrete thing. The interest which plaintiff desired to protect was the entire interest as owner in fee of the property in question. It was this interest which he submitted to defendant company as the subject matter of insurance. It was for the company then to examine the evidence of his title and to say whether or not it would assume the risk of making good to him the injury which would result in case his claim of title to the entire interest should prove defective. * * * The policy applied to the situation as it then existed. It insured the plaintiff against defects, unmarketability, liens and incumbrances as of that date. It said to him: you are, in our judgment, the owner in fee of the entire interest in this property and we will back our opinion by agreeing to hold you harmless up to the amount of the policy in case for any reason our judgment in this respect should prove to be mis-

taken. The risks of title insurance end where the risks of other kinds of insurance begin. Title insurance is designed to protect the insured and save him harmless from any loss arising through defects, liens or incumbrances that may be in existence, affecting the title when the policy is issued. It does not protect against any claims arising after the issuance of the policy." * * *

"Insurance carries with it the idea of protection against some risk. If there were no risk, there would be no cause for insurance. The underlying principle of insurance is the contribution of small sums by a large number of insured to a common fund from which to indemnify those who actually suffer the loss, which might have fallen upon any of them."

An analysis of a little policy will show its superiority to all the other systems of title protection.

First, it is strictly an insurance contract by which the insurer assumes a risk and if a loss is suffered the insurer agrees to compensate the insured in a specified amount for a stated premium, in the manner and subject to the conditions of the policy. The property as such is not insured, but the title to or an interest or estate in the property is insured.

What interest a person has in property is wholly a matter of opinion, and therefore, a title policy constitutes really the opinion of the title company reenforced with its agreement to insure its opinion. The difference between a title policy and a guaranteed certificate is that a policy is a contract to pay loss, and therefore as often as a loss is sustained an action lies on the policy. And further, the statute of limitations does not begin to run against the policy until a loss is suffered, because it is only when a loss is suffered then an action will lie on the policy. Of course, in an action on a policy, questions of mutuality of contract or skill or negligence have no place; they do not constitute defenses at all. One feature of a title policy should be noticed and it is unusual as compared to other insurance and that is that it insures only against risks prior to the issuance of the policy, i.e., defects, liens and encumbrances in the title prior to the date of the policy. No liability accrues for defects which arise after the issuance of the policy. In other words,

it is the title or estate or interest of the insured in real estate at the time of the issuance of policy which is the subject matter of the policy.

Some interesting cases have arisen in this field on the question as to whether a title policy is a mere wager and therefore void, but it has been definitely settled that title insurance is not a wager and that the owner of a title has an insurable interest. Thus it is said in the case of *Empire Development Co. vs. Title Guarantee and Trust Company*, 225 N. Y. 53;

“May the owner of land insure his existing title? Or, because it is either good or bad, because in either event his situation is unchanged, because an insurance contract is said to be a contract of indemnity, is such a transaction an idle ceremony? Is the legitimate business of title insurance companies restricted practically to those cases where an intending purchaser or mortgagee completes the transaction in reliance upon the insurance contract?” . . .

“As a help to our decision we may examine the purpose and object of the contract. To a layman a search is a mystery, and the various pitfalls that may beset his title are dreaded, but unknown. To avoid a possible claim against him, to obviate the need and expense of professional advice, and the uncertainty that sometimes results even after it has been obtained, is the very purpose for which the owner seeks insurance. In no sense is the contract a mere wager.”

So far I have talked principally on the legal aspect of title policies and now I want to draw your attention to the practical advantages. I have summarized these advantages in 7 paragraphs:

(1) It frees the real estate owner or lender of money from all worry or possible loss because of a defective title resulting from a faulty examination of the public records, and expense of defending the title against claims whether frivolous or made in good faith. If the title is attacked, the company defends at its own cost, and no matter what the outcome, the owner or mortgage holder has incurred no financial loss for costs and attorneys' fees, and the worry of long and expensive law suits.

(2) It gives absolute security against loss resulting from errors of judgment on legal questions involved in the title.

(3) It insures against loss resulting from defects which because they are not in the public records cannot be discovered from an examination of the same, and which are designated as "unknown risks."

(4) It obviates much of the loss frequently resulting from rumors affecting the validity of titles to which real estate is susceptible. Such rumors, and technical defects in titles which we call fly specks, frequently give rise to cases involving the validity of titles, and resulting in long drawn out and expensive litigation, commenced by disreputable and unscrupulous claimants and lawyers for the sole purpose of creating nuisance values, i.e., with the hope of compelling the owner to settle—in short, a sort of real estate title piracy. Title insurance companies, however, provide in the policy that they will at their own expense "defend the insured in all actions or proceedings founded on a claim of title or incumbrance prior in date to the policy insured against."

(5) Another advantage of a policy is that usually it guarantees the title for all time to come. In this respect this insurance is unique in that it runs indefinitely in the future, and there is a payment only of one premium. The right of assignment is usually given.

(6) Under the title policy system, objections to title once waived remain waived and the system, therefore, tends to stabilize titles and to make them more marketable and to make dealings with them simpler and more expeditious.

(7) As an additional protection to policy holders, title companies are under the supervision of the several state insurance departments and must make ample deposits with the various states in which they do business.

Let us turn our attention briefly to the agreement to defend and what it means to a policy holder. By the way, the fact that a policy agrees to defend the holder in case his title is attacked constitutes the great difference between it and all the other systems of title protection. Now let me

show you the importance of this difference. Go back to the opinion of a lawyer. You have made a loan relying on such an opinion. You are sued in a petition for dower. You defend the suit yourself and pay all costs and attorney's fees. If you defeat the dower suit you have no cause of action against the attorney, since you sustained no loss. So even if you win you lose. If you actually lose your suit, then you must sue the attorney, prove a difficult case and if you win this suit you get a judgment against the lawyer. If he has money perhaps you can collect it, but if he charges for examining abstracts at the prevalent rates he won't have any money. Again it is a case of you win—you lose.

The guaranteed certificate of title is much the same. If your title is attacked, you must defend it yourself, pay your own costs and attorneys' fees. If you win the suit you have lost your costs and attorneys' fees, and if you lose the suit you have a remedy against the company if it is the first loss, if the statute of limitations has not run, and if the company is solvent.

Now let us see how it is under the title insurance system. Your title is attacked. The company has agreed to defend. You notify the company and it defends you in the suit. You have no costs to pay, no attorneys' fees—nothing. If the suit is won your title is cleared. If the suit is lost you receive a check for the full amount of the policy. So you see a policy is not merely an agreement to pay a loss with a lot of red tape before the loss is paid. It is also an agreement to defend you, and I think that is where a title policy is of the greatest practical value.

I can think of many cases where an owner's title was attacked, and where after long and expensive litigation his title was sustained. It often happens that in such cases the expense of litigation exceeds the value of the property involved. In the notorious Streeter litigation in Chicago, this was actually the fact. One of those suits involved two lots in Chicago near the lake front, of which Streeter, being fond of the lake front and North East winds, surreptitiously and in the night time took possession, claiming title. The owner had a policy and notified us of the situation. Suit was commenced in 1911 against Streeter and after almost

innumerable hearings before a master in chancery over a span of seven years, a decree was entered in 1918 under which Streeter was evicted, his house demolished and possession restored to the true owner whom we had guaranteed. The cost of this litigation far exceeded the value of these two lots, and they were indeed very valuable lots. The litigation did not cost the holder of the policy one cent, but imagine the owner's plight without a policy. In such a situation a donation of the lots to Streeter would have been wise economy. This case I think, more forcibly than any other I know of illustrates what this agreement to defend means to a property owner or a lender of money on real estate securities.

I desire to elaborate a little more on one or two of the other advantages enumerated above.

Let us now focus our attention on the subject of risks. What risks in a title are there against which an investor wants to be protected and which are guaranteed against by title insurance? There are two kinds of risks in every title insured, the known risk and the unknown risk. By the known risk I mean a defect in the title which is discovered in the examination but which is thought inconsequential and against which the title is insured. Of course, I assume that there is no perfect title, and that every title has its defects and it is these defects which constitute what I call known risks. In guaranteeing against such known defects, the company takes the risk that the defect is not of such consequence as to result in loss to the owner of the title or the holder of a mortgage. If the company's conclusions are wrong and a loss is suffered by the insured, the company, of course must pay. For instance, the company is called upon to guarantee a title and in the chain of title there appears an unsatisfied mortgage 35 years old. There are various circumstances, such as several conveyances since the making of the mortgage, together with other evidence presented to the company that the mortgage has been paid, and thereupon the company guarantees the title free and clear of this mortgage. This is a known risk. If prior to the running of the statute of limitations the mortgagor shall have made a new promise to pay, this will toll the running of the statute even as against the property guaranteed and the mortgage,

notwithstanding its age, will be a valid lien. The company is liable.

This guaranteeing against known risks has become quite a fine art and has proved to be of great advantage in facilitating the marketing of real estate and the making of loans on real estate. In many cases the companies for an additional premium take additional risks and many times by securing the company against loss, a policy is procured insuring a title which would otherwise be wholly unmarketable without first having gone through a dry cleaning process in the courts. Of course, such a thing is absolutely foreign to any other systems of title protection.

Now as to the unknown risks—these are many. They may be divided into two classes. First, defects, liens and encumbrances that are overlooked by the company's title examiners and therefore not known to the company at the time the policy issues; and second, those which cannot be discovered from a mere examination of the title. This second kind of unknown risk comprises a large class of pitfalls.

Within the limits of this paper it is possible to point out only the most familiar of them. Thus, the insanity of a grantor gives rise to an action by his guardian to set aside the deed or mortgage upon the return of the consideration. The loss here would arise where the property had increased greatly in value or the money has been dissipated. Insanity would not appear of record and is an unknown risk which is present in every title.

And so if a grantor in the chain of title is a minor a similar situation arises.

And if a deed is forged, the grantee gets no title whatever and a lender of money on a mortgage would have no security at all. In this case the guarantee company is liable for the loss of the title where it has guaranteed a grantee in a forged deed or a forged mortgage.

In fact, forgery is probably the greatest source of danger in dealing with real estate titles. All the title insurance companies have suffered large losses in recent years from this source. The title companies find it quite difficult to protect absolutely from this danger, but by extreme vigi-

lance it is possible to avoid too great losses in this connection. The methods employed to detect forgeries of mortgages are too elaborate to discuss here, but they are quite effective and will tend to decrease losses from forgeries materially.

Similarly, if a deed in the chain of title is not delivered, no title passes and the company is liable. An instance of this might interest you. I speak of a case in the Supreme Court reports of the State of Illinois. (*Weber v. Christen*, 121 Ill. 91).

Christen and wife in January, 1884, executed two deeds to Herman and Bruno Weber, nephews of Mrs. Christen. They had no knowledge of it at the time, but when some time afterwards they were informed of the execution of the deeds they expressed their assent. One of the nephews was a minor. The deeds were properly recorded by Christen the day after their execution and shortly afterwards taken by him from the Recorder's Office and kept by him until his death in March, 1885, and from that time on till the suit was begun they remained in the exclusive possession and control of Mrs. Christen.

The nephews brought an action of ejectment against her.

From her evidence it appeared that the object in making the deeds was to put the property beyond the reach of Christen's creditors. The court held that although Christen's purpose was to make the public record show title in his wife's nephews without parting with the title himself, owing to the facts and to the control of the deeds by the grantor after it was recorded, there was no intention to part with the deeds or the estate in the land, and that, therefore, the deeds never took effect for want of delivery. If a title company had guaranteed the grantees' title, it would have been liable even though this defect in title did not appear of record.

And so if after the making of a deed the name of the grantee was inserted in a blank space left therefor, the deed would be void and no title would pass and, of course, any mortgage based on such a title would be worthless.

And so if a grantor designates himself as a bachelor and he is in fact married; there would be an outstanding right of dower and possibly homestead.

A deed made by an attorney-in-fact whose power was fabricated or under a power of attorney after the death of the principal passes no title.

Identity of persons in the chain of title—thus a deed may be made by a person by the same name (but having no interest whatever in the title) as the holder of the title. This would not constitute a forgery, of course, but no title would pass.

It would serve no useful purpose to extend this discussion any further. I think the superiority of Title Insurance over other systems of title protection has long been an established fact, evidenced by the extent to which title insurance is in use throughout the country.