INSURANCE**LEGAL**NEWS

TITLE INSURANCE: FREQUENTLY ASKED QUESTIONS AND ITS IMPORTANCE IN REAL ESTATE TRANSACTIONS

by Thomas C. Arendt and John G. Cameron, Jr.

Real property purchasers and mortgage lenders routinely purchase title insurance. Many of them are not, however, aware of the complexities of the product that they are purchasing. This is the third article in a series of three where we provide answers to frequently asked questions. The last article in this series can be found in the previous *Insurance Legal News*, available at http://www.dickinson-wright.com/News2.aspx?id=727. The series is intended to help unravel some of the intricacies of title insurance. This article necessarily is general in nature and does not attempt to deal with state-specific matters, such as the lawyer's role as agent for a title insurer or the commitment/guaranty/policy procedure used in a transaction.

Are there any special or unusual features in a title insurance policy?

Like any form of insurance, title insurance is given on and subject to the terms and conditions of the policy, which are contained in the "fine print." That fine print describes when and how claims must be made, sets forth the insurance company's duty to defend, and describes the limits of coverage. Any purchaser of title insurance should be aware of two particularly important terms.

First is the standard arbitration provision, which requires any dispute arising under the policy to be submitted to binding arbitration unless the amount of the original policy is in excess of $1 million.

Second is a "co-insurance" provision stating that if the insured property is improved, the owner of the property must apply for and receive increased coverage under the title policy or, in the case of a loss, be faced with coverage that is reduced from the original face amount of the policy in a proportion roughly equal to the ratio the value of the property as improved bears to the acquisition cost of the property.

Must title insurance be renewed periodically?

Ordinarily, no, a title insurance policy need only be purchased once. After that, it continues in force in accordance with its terms, and no further premium must be paid. An owner's title insurance policy even covers the owner, so long as he or she continues to hold the policy, if a claim is made against the owner based on a warranty he or she gives in a deed conveying out the property covered by the title policy. However, some owners' policies contain the co-insurance provision described above under which the owner must purchase additional coverage if significant improvements are made to the insured property or be subject to a proportionate reduction in coverage if a claim is made.

A lender's policy of title insurance even covers the lender, so long as it holds the policy, if it succeeds to ownership of the property because of foreclosure or conveyance in lieu of foreclosure. Thus, in an ordinary

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mortgage loan, a title insurance policy once purchased protects the lender until the loan is paid in full. Coverage does decrease, however, as payments are made on the loan. The use of more sophisticated lending practices, such as revolving credit loans, variable interest rate loans, and construction loans, can, however, result in an unanticipated reduction in, or even elimination of, a lender's title insurance coverage if special steps are not taken.

Is any protection available against laws, ordinances, or regulations relating to environmental protection?

Limited protection is in some jurisdictions available in the form of an endorsement. Presently, protection is not available to commercial lenders.

Are title insurance rates negotiable?

In some states, they are. However, the Michigan Insurance Commissioner, for example, requires all title insurance companies doing business in Michigan to file rates and to adhere to them. Price shopping may be effective, especially when endorsements are involved, but the negotiation of title insurance rates is not possible. Rates for title insurance companies are filed in Michigan by location, generally by county or a group of contiguous counties. Hence, title insurance rates vary between the Detroit area and West Michigan and between both of these and northern Michigan.

Is it best to deal with only a single title insurer?

It is not necessary to limit a lawyer's or lender's business to a single title insurer. However, service and claims procedures do differ significantly from title company to title company. A lawyer or lender may wish to establish a relationship with one or two title companies in which it feels comfortable. The volume of business that the lawyer or lender creates will help lead the title insurer to provide better service, to deal more readily with claims and, where creativity is involved, to better serve the lawyer's or lender's needs.

What other sorts of endorsements are available to enhance the coverage provided by a title insurance policy?

A variety of special coverage is available through endorsements to a title insurance policy. Some endorsements are given without charge; others require an additional premium. An inflation protection rider will often be added to a residential title insurance policy without cost. Title insurance companies may also provide endorsements to cover access, encroachments, covenants, restrictions, setback lines, and options. Special custom endorsements can be negotiated in special circumstances. Other commonly used endorsements include letter of credit endorsements (when the obligation of the customer to reimburse the lender for future draws on the letter of credit is secured by a mortgage) and zoning endorsements (that insure the property's zoning classification).

What about extensions, renewals, or modifications of a loan?

A loan may "balloon" and become due and payable, but be extended by the lender. Alternatively, modifications may be made or some sort of automatic renewal right exercised. Because the instrument insured by the title insurance policy is the mortgage and its priority and not the debt, it would seem that so long as debt exists that is secured by the mortgage, no new title insurance protection should be required. However, title insurance companies may take the view that an extension, renewal, or modification constitutes a future advance or a full reduction of the loan by payoff and the creation of a new loan. Although a lender's attorney may disagree with this position, at least in most cases, there is a risk that coverage would be denied by the title company in the case of an extension, renewal, or modification.

In such circumstances, litigation would be required. Because litigation is expensive and time consuming, and because in litigation no result is assured, the more conservative practice is to accept the title insurer's view and purchase a loan modification endorsement down-dating the coverage through the date of the extension, renewal, or modification. Such an endorsement should be considerably less expensive that a new policy of title insurance. The borrower will ordinarily bear this cost.

What are last dollar and comprehensive endorsements?

A *last dollar endorsement* provides that the liability of the title insurer under the policy will not be reduced as a result of payments on the indebtedness secured by the insured mortgage, except to the extent those payments reduce the total indebtedness secured by the insured mortgage below the amount of the policy limits. A lender should request a last dollar endorsement in a policy of title insurance unless the amount of the indebtedness is the same as or less than the amount of title insurance.

A *comprehensive endorsement* insures against such things as violation of covenants and restrictions affecting the mortgaged property and against encroachments. Many lenders insist on receiving a comprehensive endorsement when they make a commercial mortgage loan.

RECENT CASE LAW SUMMARIES

TENNESSEE COURT OF APPEALS FINDS GENERAL CONTRACTOR HAS AN IMPLIED NON-DELEGABLE CONTRACTUAL DUTY REGARDING WORK PERFORMED BY A HIRED SUBCONTRACTOR

by John E. Anderson, Sr. and Rodney D. Butler

In its recent decision in *Federal Insurance Company v Winters*, 2010 Tenn App LEXIS 652 (October 18, 2010), the Tennessee Court of Appeals held

that a general contractor has an implied non-delegable contractual duty that work be performed in a careful, skillful, and workmanlike manner.

The Emersons, homeowners, hired Winters to replace an entire roof on their house. In coming to their decision to hire Winters for the roofing work, the Emersons found on Winters' website that his company had liability insurance. Additionally, as part of the written proposal for the job to be performed, Winters included a five-year warranty with respect to workmanship. However, when it came time to replace the roof, Winters did not perform any of the work himself, but hired a subcontractor.

In the weeks that followed the roof replacement, the Emersons called Winters to fix several leaks. Those leaks were fixed by the original subcontractor that performed the roof replacement. Thereafter a leak was discovered around a drain. When Winters was called concerning the leak around the drain, he called another subcontractor, Bruce Jacobs. Winters and Jacobs agreed on a price to fix the drain issue for the Emersons. Furthermore, Winters and Jacobs signed a subcontractor agreement in which Jacobs agreed he would assume responsibility for any damage caused by his work. Winters did not participate in the work performed by Jacobs, and he likewise did not supervise, control, or instruct Jacobs on any of the work.

In the course of the drain repair performed by Jacobs, a propane torch started a fire which caused an insurance loss to Federal Insurance Company (homeowners' insurance company) in the amount of $800,000. At the time of the fire, Winters had allowed his liability insurance to lapse. The plaintiffs brought suit against Winters alleging causes of action sounding in tort (negligence) and contract. Winters moved for summary judgment stating that he did not perform or supervise any of the work performed on the Emersons' home, and cited to the subcontractor agreement he had with Jacobs. The trial court agreed, and granted Winters' motion for summary judgment. The plaintiffs appealed the trial court's decision.

In reversing the trial court's decision to grant summary judgment to Winters, the Tennessee Court of Appeals stated that the lower court had failed to "rely upon the defendant's non-delegable duty to make sure the work was performed skillfully, carefully, and in a workmanlike manner" and that "Winters' decision to subcontract out the roofing/repair work does not absolve him of his contractual duty…." Thus, the Court found that the general contractor could not insulate himself from potential liability simply by hiring a subcontractor, as the duty to ensure the work was properly performed was implied in contract and was non-delegable in nature.

On February 16, 2011, the Tennessee Supreme Court granted Winters' application to appeal the decision.

INSURER MUST SHOW ACTUAL PREJUDICE TO LIMIT RESPONSIBILITY WHERE THE INSURED FAILED TO COMPLY WITH A NOTICE PROVISION

by Ryan M. Shannon

In *Defrain v State Farm Mutual Auto Ins Co*, 2011 Mich App LEXIS 453 (March 10, 2011), the Michigan Court of Appeals determined that an insurer had to establish actual prejudice to its position to cut off responsibility where the insured did not give notice in accordance with a policy provision.

In May of 2008, William DeFrain was a pedestrian when he was struck by a hit-and-run driver and sustained severe head injuries. He notified his insurer, State Farm, of the accident three months later, in late August. On November 11, 2008, Defrain died from injuries he sustained in the accident.

The policy Defrain maintained with State Farm included uninsured motorist ("UIM") benefits, but also included a provision that a person making a claim for UIM benefits "must report an accident involving a hit-and-run motor vehicle to the police within 24 hours and to us within 30 days." *Id.* at *2. The policy additionally required a claimant to notify the insurer of a UIM claim and give it "all the details about the death, injury, treatment, and other information that [the insurer] may need as soon as reasonably possible after the injured insured is first examined or treated for the injury." *Id.* When the insurer refused to pay, citing the notice provisions, DeFrain's estate sued. Because of an ambiguity in the policy, the trial court denied State Farm's motion for summary disposition.

On appeal, the court ignored the issue of ambiguity, and instead focused on the trial court's ruling that there was no prejudice to State Farm caused by DeFrain's delay in giving notice. The plaintiff cited *Koski v Allstate Ins Co*, 456 Mich 439 (1998), in which the Michigan Supreme Court held that an insurer must establish actual prejudice before it is relieved from contractual liability under an insurance policy, even where the insured failed to timely comply with a notice provision contained in the policy, and even though compliance with the notice provision constituted a condition precedent to insurer liability.

The opinion in *Koski*, however, was in direct conflict with the Michigan Supreme Court's order seven years later in *Jackson v State Farm Mut Auto Ins Co*, 472 Mich 942 (2005), where, in lieu of granting appeal, the court vacated a judgment entered by the court of appeals and reinstated a dismissal by the trial court "for the reasons stated in the Court of Appeals dissent." *Defrain*, 2011 Mich App LEXIS at *4. The facts in *Jackson* were generally similar to those before the court in *Defrain*: the *Jackson* policy also included a 30-day notice provision with respect to a claim for UIM. There, the court of appeals dissent rejected the argument that the insurer had to establish prejudice to limit its responsibility where the insurer failed to comply with the notice provision.

In resolving the apparent conflict between the court's opinion in *Koski* and its decision in *Jackson*, the court of appeals noted that *Koski* was a "fully developed and reasoned opinion on the subject of prejudice, whereas *Jackson* is merely a cursory order," which did not address *Koski*. Because the court deemed *Koski* to be binding precedent, it affirmed the lower court's order denying State Farm's motion for summary disposition.

As of the time of writing, the deadline for appeal to the Michigan Supreme Court had not yet passed.

MICHIGAN COURT OF APPEALS REAFFIRMS APPLICATION OF "EASILY ASCERTAINABLE" STANDARD IN CASES INVOLVING AUTOMOBILE INSURER'S EFFORTS TO REFORM POLICY DESPITE INSURED'S MISREPRESENTATION

In *Titan Insurance Co v Hyten*, a published Michigan Court of Appeals opinion, the Court of Appeals reaffirmed the "easily ascertainable" rule, which requires an automobile insurer to "undertake a reasonable investigation of the insured's insurability within a reasonable period of time from the acceptance of the application and the issuance of a policy." *Titan Ins Co v Hyten*, 2011 Mich App LEXIS 211 (February 1, 2011).

In this case, the defendant, McKinley Hyten ("Defendant"), obtained a "provisional driver's license in April 2004" and subsequently "incurred multiple moving violations and had two minor traffic accidents." *Id.* at *2. On January 6, 2007, the Defendant's driver's license was suspended. *Id.*

In the meantime, the Defendant's mother, Anne Johnson ("Johnson"), contacted an independent insurance agent authorized to issue Titan Insurance Company ("Titan") policies in order to procure automobile insurance for a vehicle reserved for the Defendant's use in anticipation of reinstatement of the Defendant's license. *Id.* Johnson informed the agent of the Defendant's driver's license suspension, but advised the agent that her license would likely be reinstated on or before August 24, 2007. Thereafter, the agent filled out an insurance application on the Defendant's behalf and post-dated its effective date to August 24, 2007, in reliance upon Johnson's representation. *Id.* at *2. The application, however, did not identify that the Defendant was unlicensed as of that date. *Id.* The Defendant then signed the application, and Johnson paid $719 for the Titan insurance premium; the policy took effect on August 24, 2007, with coverage limits of $100,000 per person and $300,000 per occurrence. *Id.* at *3. Subsequent to the policy's effective date, however, the Defendant (and Johnson) learned that license reinstatement would not in fact occur until September 20, 2007. *Id.* Nevertheless, neither the Defendant nor Johnson notified the Titan agent of this change in circumstances. *Id.*

Following reinstatement of the Defendant's driver's license on September 20, 2007, she was involved in a motor vehicle accident with another vehicle resulting in injury to the driver and passenger of the other car ("Third Parties"). *Id.* After learning of the Defendant's automobile accident, Titan filed a complaint in circuit court "seeking a declaration reforming [the Insured's] insurance policy by reducing the liability coverage limits to the statutory minimum of $20,000 per person and $40,000 per event." *Id.* In its complaint, Titan asserted misrepresentation and claimed that if the Defendant or Johnson would have informed Titan or its agent that the Defendant's "driver's license had been suspended [at the time the policy was issued], it never would have accepted the risk and would not have issued the subject insurance policy, unless [the Insured] had named [herself] as an excluded driver under MCL 500.3009." *Id.* (quotation marks omitted).

The trial court, however, granted summary disposition in favor of the Defendant and concluded that, although the Defendant and Johnson may have misrepresented certain facts during the application process, Titan could have easily ascertained whether the Defendant had a driver's license. *Id.* at *5.

On appeal, Titan asserted that, because the Defendant "fraudulently misrepresented that she possessed a [valid] driver's license on August 24, 2007[,]" Titan should be entitled to reform the Defendant's "no-fault insurance policy by reducing the tort liability coverage available to the [injured parties] from the stated policy limits of $100,000 per person and $300,000 per occurrence, to the statutory minimums of $20,000 per person and $40,000 per occurrence." *Id.* at *7.

While an insurer may seek reformation and/or rescission of an insurance policy, the *Hyten* court explained that once an insurable event occurs and an innocent third party is injured in an accident in which coverage is in effect on an automobile, public policy considerations require that the insurer be "estopped from asserting rescission as a basis upon which it may limit its liability to the statutory minimum." *Id.* at *11 (quotations and citation omitted).

Secondly, under *State Farm Mutual Auto Insurance Co v Kurlyowicz*, an "automobile liability insurer must undertake a reasonable investigation of the insured's insurability within a reasonable period of time from the acceptance of the application and the issuance of a policy" and this "duty directly inures to the benefit of third persons injured by the insured." *Id.* at *15 (citation omitted). And, the Court of Appeals concluded that this "easily ascertainable" rule is based on sound legal authority. *Id.* at *22-23.

The Court of Appeals found that there was insufficient evidence of fraudulent conduct on Johnson's or the Defendant's behalf, nor was there "evidence before the Court as to whether the [Titan] insurance agent asked to see [the Defendant's] license or whether he may have taken her premium knowing that she did not have a license." *Id.* at *5. Thus, because "Titan could have easily ascertained [the Defendant's] misrepresentation and the implicated coverage benefits innocent third parties," the Court of Appeals held that "Titan [could] not reform [the Defendant's] policy to reduce the residual coverage to the statutory minimum limits[.]" *Id.* at *18.

ATTORNEY GENERAL'S ACTION AGAINST MERCK FOR ALLEGED VIOXX MISREPRESENTATIONS BARRED BY STATUTE

by Ryan M. Shannon

In *Attorney General v Merck Sharp & Dohme Corp*, 2011 Mich App LEXIS 513 (March 17, 2011), the Michigan Court of Appeals held that the attorney general's action against Vioxx's manufacturer, Merck, Sharpe & Dohme Corporation ("Merck"), was barred by the immunity provision in a 1995 statute. See MCL 600.2946(5).

In May of 1999, the Federal Food and Drug Administration ("FDA") approved Vioxx for the treatment of osteoarthritis and other conditions. In 2004, after independent studies showed that persons who used Vioxx had an increased risk of heart attack, its manufacturer, Merck, voluntarily pulled Vioxx from the market.

The Michigan attorney general subsequently sought to recover Medicare payments made on behalf of persons using Vioxx by filing a claim against Merck under the Medicaid False Claim Act ("MFCA"). *See* MCL 400.601 et seq. The attorney general alleged that Merck made false and deceptive statements about the safety and efficacy of Vioxx, and that Merck knew, as early as 2000, of the increased risk of heart attack associated with the use of its product. The attorney general argued that, had the state known of the increased risk of heart attack, it would not have made $20 million in paying for all or part of Medicaid beneficiaries' prescriptions for Vioxx, and return of those disbursements was merited.

Merck moved for summary disposition, arguing that the suit was ultimately a product liability suit for which the Michigan Legislature had exempted Merck from liability so long as the drug had received approval from the FDA and was labeled in accordance with FDA requirements. See MCL 600.2946(5).

The trial court denied Merck's motion for summary disposition on the basis that the attorney general's claims did not constitute a product liability action because they were brought pursuant to the MFCA and did not, like a product liability action, require proof of a defective or unsafe product. In reviewing the legislative history, the trial court also concluded that the Michigan Legislature did not intend to foreclose the attorney general's action under the MFCA.

In reversing, the Michigan Court of Appeals looked to the definition of "product liability action" in the statute, which provided that a "'product liability action' means an action based on a legal or equitable theory of liability brought for … damage to property caused by or resulting from the production of a product." *See* MCL 600.2945(h).

Because the attorney general's action was "based on a legal or equitable theory of liability," and was brought for "damage to property" resulting from the production of Vioxx, the court of appeals held that the action constituted a "product liability action" and was barred by the statute. The attorney general's action, the court reasoned, was "based on alleged misrepresentations regarding the safety and efficacy of Vioxx [which] constitutes damage to property." *Id.* at *16. "Although a claim under the MFCA does not require proof of an unsafe product," the court reasoned, "in this case the safety and efficacy of Vioxx is central to plaintiff's claim … ." *Id.* at *18. Because the FDA approved the drug, and because the plaintiff's claim constituted a "product liability action" under the statute, the court concluded that "Merck is not liable … and the trial court erred by denying Merck's motion for summary disposition." *Id.*

As of the time of writing, the deadline for appeal to the Michigan Supreme Court had not yet passed.

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