Title Insurer's Duty to Defend Addressed in Several Court Cases

Several cases illustrate the risk in a title insurance company's obligation to defend the insured.

By James Bruce Davis

It is well known that title insurance obligates the insurance company to pay a loss that a policyholder sustains if his title to real estate is not as stated in the policy. Another benefit of title insurance is the company's duty to defend litigation in which a third party challenges the policyholder's title.

The company's duty to defend protects the policyholder from the risk of having to pay attorneys' fees, court costs and related expenses. As insurance companies know, the costs of defending a policyholder's title can be expensive.

Defending a policyholder's title is not without benefit to the insurance company. By defending the policyholder, the company may be able to defeat a claim that, if successful, would obligate the company to pay a loss. To assure this benefit, the policy gives the company the right to sue in the policyholder's name to fix title problems. If the company succeeds in fixing a title problem by litigation or any other lawful means, the company fulfills its obligations under the policy, and need not pay a loss.

The policy provisions regarding the defense of the insured title are usually a win-win bargain for the company and the policyholder because they have a common interest in defending the title. However, situations sometimes arise in which the company and the policyholder do not see eye to eye. Two of those situations were the subject of discussions by the ALTA Title Counsel Committee.

The first situation arises when the cost of defending the policyholder's title becomes exorbitant. In that situation, the company would prefer to skip the defense and pay the loss. The policyholder, in contrast, may want the title problem fixed, no matter what the fix costs. After all, the company is paying the legal bills.

This issue arose in **Mortensen v. Stewart Title Guaranty Co.** *(235 P.3d 387, Ida. 2010)*, decided by the Supreme Court of Idaho in 2010. Mortensen owned a parcel of land near Coeur d'Alene, Idaho, for which he purchased title insurance from Stewart Title. For access to the property, Mortensen used a primitive road that crossed property owned by Dennis and Sherrie Akers. Although Mortensen had an easement for access over part of the Akers' property, the easement did not extend all the way to the nearest public road. For a time, the Akers had no objection to Mortensen's use of the access road, but trouble arose when Mortensen decided to subdivide his property into a housing development and needed to widen the access road for that purpose. After the Akers declined Mortensen's request for an easement, Mortensen and a business partner entered onto the Akers' land, bulldozed a gate, and began excavating the road. The Akers responded with a suit for trespass, negligence and quiet title.

Stewart Title provided counsel to defend Mortensen on the quiet title claim and, due to the difficulty in separating causes of action, defended him on the tort claims as well. After a seven day trial, the trial court found for the Akers and awarded them $10,000 in damages for emotional distress, $51,000 in treble damages for trespass and $150,000 in punitive damages. Two appeals followed. In the second appeal, the Idaho

Supreme Court ruled that Mortensen had a 12.2-foot wide prescriptive easement to use the access road, but remanded the case to the trial court for further fact finding on the exact location of the easement and a redetermination of damages. After the third trial, Mortensen wanted to appeal again, but Stewart Title decided enough was enough. Stewart Title paid Mortensen the $200,000 policy amount, and said the company was through defending him.

Mortensen responded by suing Stewart Title, claiming the company had breached its duty to provide a usable route to his land. The Idaho Supreme Court seemed to have little difficulty in rejecting this claim. The Court did so on two grounds.

First, an insured is entitled to recover only up to the amount of the insurance coverage under the policy, and there was no dispute that Stewart Title had paid Mortensen the $200,000 policy amount. Second, Section 6 of the policy (apparently a 1992 ALTA owner's policy) plainly gave Stewart Title the option of terminating all liability under the policy, including liability for defense costs, by paying the amount of the insurance, together with any legal defense costs authorized by the company prior to the exercise of this option. Therefore, Stewart Title did not breach the insurance policy by opting to pay the policy limit.

Another potentially troublesome situation arises when someone sues a policyholder on multiple claims, only some of which are insured by the policy. Under standard ALTA policies, the insurance company's obligation to defend "is limited to only those stated causes of action alleging matters insured against by this policy."

In Mortensen's case, Stewart Title decided to defend him against all of the Akers' claims, even though some of the claims, such as the claim for trespass, were not covered by the policy. Stewart Title did this because of the difficulty in apportioning defense costs between covered claims and non-covered claims. The defense of the Akers' quiet title claim overlapped with the defense of the trespass claim.

In similar situations, title insurance companies sometimes decide to defend only the claims that the policy covers. However, defending fewer than all claims received mixed reviews in the court decisions presented at the Title Counsel Committee meeting. One federal court, applying Illinois law, ruled that a title insurance company was obligated to defend only the covered claims. Another federal court, applying Texas law, ruled that a title insurance company had to defend all of the claims against the insured, even though the policy did not cover all of them.

In **Philadelphia Indem. Ins. Co. v. Chicago Title Ins. Co.** ***(Case No. 09 C 7063, 2010 U.S. Dist. LEXIS 69581, N.D. Ill. July 13, 2010),*** Chicago Title and the Philadelphia Indemnity Insurance Company (Philadelphia Indemnity) both provided insurance to a mortgage lender, Western Capital Partners LLC. Several real estate developers filed a six-count complaint against Western Capital over a mortgage foreclosure Western Capital had commenced against them. Chicago Title agreed to defend four counts of the suit, but declined to defend the remaining two counts because the policy did not cover them. Western Capital then requested Philadelphia Indemnity, its liability insurance company, to defend the remaining two counts.

Philadelphia Indemnity objected, arguing that Illinois law required Chicago Title to defend the entire suit, and claiming that Philadelphia Indemnity's policy should be considered excess coverage. Philadelphia Indemnity filed a declaratory judgment action to resolve the dispute, and then filed a motion for judgment on the pleadings.

The Philadelphia court agreed that, absent contractual language to the contrary, Illinois law obligates an insurance company to defend all claims in a complaint if the policy covers at least one of the claims. However, the Court was of the opinion that this general rule did not apply if the insurance contract clearly limited the insurance company's duty to defend. Upon determining that the ALTA policy used by Chicago Title

Top Lawsuits Impacting the Title Industry

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clearly limited the company's defense obligation to covered claims, the Court denied Philadelphia's motion for judgment.

In **Lawyers Title Ins. Corp. v. Graham Mort. Corp.** *(Case No. 4:09-cv-262, 2010 U.S. Dist. LEXIS 64125, E.D. Tex. April 16, 2010; adopted, 2010 U.S. Dist. LEXIS 64222, E.D. Tex. June 28, 2010)*, a partnership, Douglas/Hall, Ltd. (DHL) purchased property from a trustee. She took back a mortgage on the property to secure the purchase price, but agreed to subordinate her lien to three mortgages securing Graham Mortgage Corp. (Graham). After DHL defaulted on the trustee's note, she sued Graham to set aside her subordination agreements on the grounds that they had been procured by fraud. Graham then called upon its title insurance company, Lawyers Title, to defend the suit. Lawyers Title filed a declaratory judgment action, seeking a ruling that the company had no duty to defend Graham.

The complaint by Lawyers Title made broad allegations that DHL, its partners and/or Graham had perpetrated the alleged fraud. Lawyers Title argued that these allegations brought the claim within policy exclusion 3 (a), which excludes coverage of title defects "created suffered, assumed or agreed to by the insured claimant." The Court disagreed because the phrase "and/or" could be read to say that DHL and its partners had perpetrated the fraud, but Graham had not. Since the policy would cover Graham if it were innocent of the fraud, Lawyers Title had a duty to defend.

The Lawyers Title court then turned to whether Lawyers Title had a duty to defend non-covered claims alleged in the complaint. The Court held, "the rule in Texas is clear: 'If a complaint potentially includes a covered claim, the insurer must defend the entire suit.'" The reasons for this rule, according to the Lawyers Title court, are the difficulty of pro-rating defense costs between covered and non-covered claims and the impracticality of having separate defense counsel represent the policyholder for different claims in the same suit.

These cases illustrate risks inherent in a title insurance company's obligation to defend the insured. A litigant who pays his own legal fees has an incentive to settle, but this incentive is lacking if an insurance company is paying the lawyers. The company may buy its way out of the duty to defend, but the price of the buyout may be the full policy amount (See, e.g., **Fleishour v. Stewart Title Guar. Co.**, *2010 U.S. Dist. LEXIS 101867, E.D. Mo. Sept. 28, 2010*). In many jurisdictions, as in Texas, the company must defend all of a plaintiff's claims against the insured, even if only one of the claims would be covered by the policy.

The lesson in these cases for underwriters is well known: beware of insuring titles that are subject to known litigation risks.

An implication for claims administrators and coverage counsel is to identify cases where defense costs could spiral out of control and look for settlement opportunities. Claims under owner's policies appear to be riskier in this regard than claims under loan policies. In the author's experience, owners generally are inclined to insist on the title they bargained for, while lenders are generally willing, if not obligated, to accept an indemnity payment.

Another implication for claims administrators and coverage counsel is to be mindful of local law, and exercise judgment, in considering whether to defend less than all of a plaintiff's claims against a policyholder.

Irrespective of the policy terms, state law may obligate the company to defend the entire suit. And, even if the company is not obligated to defend the entire suit, that might prove to be the wiser course of action. ■

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