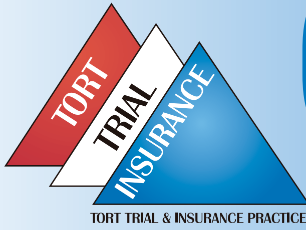

Committee News

ABA
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Summer 2012

Title Insurance Litigation Committee*

EXCEPTIONS CAN SAVE TIME AND MONEY

By: David B. Herbert, Esq., Thomas C. Corts, Esq. and Will Caldwell, Esq.

In November, 2011 the case of G.C. Finance, LLC v. Old Republic National Title Insurance Company finally came to an end with the Opinion in that case from the United States Court of Appeals for the Sixth Circuit, November 29, 2011, Case No. 10-5509 (not recommended for full-text publication) which reviewed the District Court's decision on the issue of whether a document amending previously recorded easements constituted a lien and/or encumbrance on the title to property and thus required the title insurance company to defend and possibly indemnify under a title policy.

G.C. Finance, a financial institution from California initiated the lawsuit after Old Republic refused to provide a defense to G.C. Finance in a lawsuit brought by Columbia Gulf Transmission Company ("Columbia Gulf"). G.C. Finance had made a substantial loan on a piece of property in Tennessee to develop a golf course inside an exclusive planned unit development. After a bankruptcy sale, G.C. Finance owned of the golf course encumbered by several utility easements recorded when the golf course was farmland. The easements secured the rights of Columbia Gulf to maintain and repair gas transmission pipes within the easements and thus underneath a portion of the golf course. However, prior to G.C. Finance's purchase of the property, Columbia Gulf also recorded a "Partial Release of Right-Of-Way Agreement" ("Partial Release") that purported to amend

Continued on page 14

*Before citing any case or legislative enactment mentioned or discussed in this Newsletter, be sure that the decision has not been overruled or modified, or that the statute has not been amended, subsequent to the time these summaries were prepared.

IN THIS ISSUE:

Exceptions Can Save Time And Money 1
Greetings from the Chair 3
Connecticut Adopts First In Time Priority – Finally! 5
Tender Of Loss And Termination Of Title Insurance Policy Obligations 7
Title Insurance Coverage For NYC Emergency Repair Liens 9
Maryland Appellate Court Rejects Vicarious Liability Claims Against Title Insurer. 10
Lawler v. Fidelity National Title Insurance Company: In Good Faith: A Title Insurer's Right to Prosecute Prior to Payment 11
Washington Court Refines Doctrine of Equitable Subrogation 14
2012 TIPS Calendar 17

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Committee Leadership

Chair
Tammy L. Ortman
Mercer Belanger, P.C.
111 Monument Circle, Ste 3400
Indianapolis, IN 46204-5134
(317) 636-3551
tortman@indylegal.com

Chair-Elect
Ronald A. Damashek
Stahl Cowen Crowley Addis, LLC
55 W. Monroe St., Ste 1200
Chicago, IL 60603-5127
(312) 377-7858
rdamashek@stahlcowen.com

Past Chair
Jennifer Stephens Gaytan
Fidelity National Title Group
601 Riverside Ave., Bldg. 5
Jacksonville, FL 32204-2901
(904) 854-8936
jennifer.gaytan@fnf.com

Vice-Chairs

Treasurer
William Jacob Long, IV
Burr & Forman, LLP
217 Dexter Ave.
Birmingham, AL 35213-3721
(205) 251-3000
jlong@burr.com

Membership
Shawn Rader
Lowndes Drosdick Doster Kantor & Reed, P.A.
P.O. Box 2809
Orlando, FL 32802-2809
(407) 843-4600
shawn.rader@lowndes-law.com

Newsletter
Ryan C. Squire
Garrett & Tully, P.C.
225 S. Lake Ave., Ste 1400
Pasadena, CA 91101-4893
(626) 577-9500
rsquire@garrett-tully.com

Jerel Johnston Hill
Law Office of Jerel J. Hill
1420 Stonehollow Dr., Ste B
Kingwood, TX 77339-2494
(281) 358-3560
jerel@jjhlawoffice.com

Website
Steven Ray Parker
Balch & Bingham, LLP
1901 6th Ave. N., Ste 2600
Birmingham, AL 35203-4644
(205) 251-8100
sparker@balch.com

T. Morgan Ward, Jr.
STITES & HARBISON, PLLC
400 W. Market St., Ste 1800
Louisville, KY 40202
(502) 681-0406
mward@stites.com

TIPS Counsel Representative: Robert P. Redemann, *Perrine McGivern Redemann Berry & Taylor, P.C.*, 1437 S. Boulder Ave., Ste 620, Tulsa, OK 74119-3621, (918) 382-1400, rredemann@pmrlaw.net

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GREETINGS FROM THE CHAIR

Are you ready for the next meeting of The Title Insurance Litigation Committee? It will be fantastic. We are participating in the ABA Annual Meeting in Chicago, Illinois, August 2nd through the 7th, 2012. Our Committee's program will be on Friday morning, August 3rd, 8:30 – noon. If you haven't registered, do so soon! Our three hour program counts as only one session for the bargain price of $90 after registration. As usual, we have dinner plans so that we can get reacquainted, share stories and meet new friends. Please join us. With the encouragement of some young at heart, we are also planning some late evening activities to enjoy the windy city after dinner on Friday.

The registration process comes in two parts:

1. the ABA program registration with special hotel rates; and
2. the Committee registration form for Thursday's dinner, Friday's dinner, Friday's late night fun and Saturday's business meeting. This registration form has been emailed to our listserv members. If you missed it, check out our website at http://apps.americanbar.org/dch/committee.cfm?com=IL226600 you'll find it there.

If you missed the Boston meeting in April, you missed a great meeting and opportunity to join practitioners and in house counsel from across the country; don't let this next opportunity pass you by. Here are just a few of comments received:

> *The Boston meeting was wonderful. The title insurance litigation committee is certainly a great group of people! Thank you so much for welcoming me into the group. The event was so well organized and informative (not to mention, the dinners were fantastic)! I felt the meeting went off very well, super venue, too. The CLE information was valuable and timely. Kudos. Thanks for putting on the great conference. This was a superior two day experience. Thanks.*

Our in house sponsorship program will continue so if you are an in house counsel and would like to attend with a little help, please communicate with me, tortman@indylegal.com or Jay Long, jlong@burr.com. If you would like to sponsor an in house counsel attendee also communicate with me or Jay, please. This is a very successful program which we want to see grow for the benefit of everyone.

Our second Committee initiative is to expressly invite our associates and partners to join this vibrant and valuable time together.

Enjoy the Spring Newsletter and we will look forward to seeing you in Chicago! ⚖

Tammy Ortman, Chair
Title Insurance Litigation Committee

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We have a fantastic meeting planned that includes several valuable CLE programs to help you in your practice, various opportunities to network and socialize with your TIPS friends, colleagues and clients at events including our Welcome and Diversity Reception at the Sheraton and the James K. Carroll Leadership and Awards Dinner at the beautiful and historic Chicago Symphony Orchestra, along with the chance to give back through our public service projects.

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CONNECTICUT ADOPTS FIRST IN TIME PRIORITY – FINALLY!

By: Thomas J. Donlon

Have you ever included a well-accepted legal principle in a brief or memorandum, and then searched fruitlessly for an actual case that states it? As your frustration mounts with every wasted minute, you say, "but everybody knows that's the law!" *Hudson Valley Bank v. Kissel*, 303 Conn 614, 35 A.3d 260 (2012), ends that frustration in Connecticut on one issue at least.

The legal principle ultimately confirmed in *Kissel* was "first in time is first in right;" requiring the proceeds of a foreclosure sale to be distributed to lienholders in order of their priority of filing. Connecticut practitioners, writers and title insurers had long accepted and applied this principle. The Connecticut Supreme Court had even relied on the principle 60 years ago in *Brown v. General Laundry Service*, 139 Conn. 363, 94 A.2d 10 (1952).[1] However, the U.S. Supreme Court vacated the *Brown* decision, finding Connecticut had improperly given local taxes priority over federal taxes. *See United States v. New Britain*, 347 U.S. 81 (1954). While lower courts had referenced the "first in time" principle in the interim, the Connecticut Supreme Court did not address it again before *Kissel*.

The case has unusual facts. Andrew Kissel received a $1.6 million mortgage from Washington Mutual Bank in July 2004 to purchase a home in Greenwich. Eight months later, by recording a forged release of the Washington Mutual mortgage, Kissel fraudulently obtained another mortgage for new construction from Hudson Valley Bank of $4.5 million. In May and June 2005, Kissel used the same scheme, recording forged releases, to obtain two more mortgages on the property – $1.0 million from Independence Community Bank and $4.5 million from Ridgefield Bank. Eventually, the scheme was discovered and the banks commenced foreclosure actions.[2]

Hudson Valley obtained a foreclosure judgment first. The property, appraised for $2.2 million, was scheduled for sale in March 2007. However, any foreclosure sale in the Hudson Valley action would be subject to the prior Washington Mutual mortgage, depressing the price. As First American Title had issued policies on both the Washington Mutual and Hudson Valley mortgages, prior to the foreclosure sale First American elected to purchase Washington Mutual's note and mortgage, and then subordinate them to Hudson Valley's. As a result, the foreclosure sale brought $100,000 more than the appraisal. After Hudson Valley's judgment was paid, First American, as holder of Washington Mutual's now second priority mortgage, moved for award of the over $400,000 surplus.

Stewart Title Guaranty Company, which had issued a policy for the Independence Community mortgage in third position, objected. Stewart claimed that, due to Kissel's fraud, the surplus should be apportioned between the two title insurers. Based on an unrecorded federal court judgment, including damages from another defaulted Kissel mortgage on a separate piece of property, Stewart contended that it should receive 70% of the surplus.

Stewart initially convinced a trial court judge to apportion the surplus, giving Stewart 70%. First American sought reargument, contending the court ignored the "first in time" rule. On reconsideration, the trial court refused to apply the "first in time" rule, but awarded First American the entire surplus based on the equitable doctrine of *pari passu*. Stewart Title appealed.

Much of the *Kissel* decision dealt with preliminary procedural questions.[3] Once the court reached the central issue, it took only a paragraph to reaffirm the "fundamental principle" that "a mortgage that is recorded first is entitled to priority over subsequently recorded mortgages …". *Id.*, at 626. The court affirmed the award of the entire surplus to First American on this alternate ground, rejecting Stewart's argument that equitable apportionment should apply.[4] Although it took 60 years, *Kissel* determined that "first in time is first in right" really was the law as everybody 'knew.'

Thomas J. Donlon is counsel at the firm of Robinson & Cole LLP in their Stamford, Connecticut office and a member of the firm's Appellate Team. Mr. Donlon is Co-Chair of the ABA Section of Litigation's Appellate Practice Committee and successfully represented First American Title on appeal in the Kissel case.

1 An early case, *Beers v. Hawley*, 2 Conn. 467 (1818) referred to the principle in *dicta*.

2 In a bizarre twist, Kissel was murdered during the foreclosure proceedings.

3 S*ee* 303 Conn., at 616-626.

4 The court noted that *pari passu* applied to bankruptcy proceedings, not to foreclosures.

TENDER OF LOSS AND TERMINATION OF TITLE INSURANCE POLICY OBLIGATIONS

By: Lawrence P. Heffernan, *Robinson & Cole LLP*, Boston, MA

Introduction

The primary benefits of title insurance are indemnification against loss or damage sustained as a result of covered risk and defense of claims covered by the policy. One of those benefits, however, can be invoked to terminate the other, i.e., by tendering to the insured its loss or damage, the title insurer can terminate its obligations under the policy, including the duty to defend. This is particularly valuable where the impact of the controversy is relatively minor, but the costs of the defense or cure far outstrip the actual loss that the insured would suffer. For example, failure of title to a small piece of a parcel may be remedied by an action for adverse possession, but such an action can be fact-intensive and costly. Tendering the loss to the insured may also be an attractive option when the title insurer finds itself in an "in for one, in for all" jurisdiction which requires a title insurer to defend all claims asserted against the insured even those which are not related to the title or covered risks.

For a long time there was very little case law interpreting and applying the tender of loss provisions, but more cases which address the issue have been reported recently, perhaps because the provision is being invoked more often.

The Policy Provisions

American Land Title Association title insurance policy forms have long had provisions for tendering loss, but the language has evolved and strengthened over the years. Section 6 of the conditions and stipulations of the 1992 ALTA owner's policy specifically provided that the title insurer can tender the amount of insurance or the loss or damage under the policy and that, upon the exercise of either of those options, all liability and obligations to the insured shall terminate, including the obligation to defend, prosecute or continue any litigation.

These provisions were carried forward in the 2006 ALTA owner's policy under Section 7 of the conditions.

Case Law

The first reported decision interpreting the tender of loss provisions was Batdorf v. Transamerica Title Ins. Co., 41 Wn. App. 254 (Wash. Ct. App. 1985). In Batdorf, the title insurer defendant initially undertook the defense of a quiet title action against its insureds, but subsequently tendered the policy limits ($6,800.00 and $5,000.00 respectively) and the attorneys' fees incurred up to that point and withdrew from the defense.

After the tender, the insureds continued to defend the quiet title action, but eventually settled. The insureds then brought suit against Transamerica Title for legal fees and costs incurred after the tender ($5,929.08 and $3,896.45 respectively). The conditions of the applicable policy provided that "(T)he Company may at any time pay this policy in full, whereupon all liability of the Company shall terminate. In reviewing the policy provisions, the Washington appellate court concluded that "[t]he language in this contract is not ambiguous, either clause by clause or when all clauses are taken together. The policy clearly gave Transamerica the option to settle adverse claims, pay its insured the policy limits or defend to judgment." Id. at 258. Accordingly, the appeals court affirmed the trial court's granting of summary judgment in favor of the insurer, noting that "[b]y paying up, the insurer removed all of its further liability. Therefore, attorneys' fees, incurred after the payment, were incurred about a "claim" which was no longer covered by the policy." Id.

The United States District Court for the District of Connecticut reached a different conclusion in Chicago Title Ins. Co. v. Kent School Corp., 361 F. Supp. 2d 4 (D. Conn. 2005). Kent School arose out of a $100,000 1966 title insurance policy that pre-dated the ALTA forms. In 1975 a Native American tribe brought suit against the insured, Kent School, and other landowners claiming a large swath of property in northwestern Connecticut. In 1993 the suit was dismissed because the plaintiff had not been granted tribal status by the United States Bureau of Indian Affairs, but it was reinstated in 1998. After incurring nearly $700,000 in defense fees and costs the title insurer tendered the policy limits and brought an action seeking a declaratory judgment that it was no longer obligated to defend the insured. On cross motions for summary judgment the federal court found that the 1966 policy placed Chicago Title under a continuing duty to defend Kent School and that the policy provisions did not allow Chicago Title to terminate

Continued on page 15

TITLE INSURANCE COVERAGE FOR NYC EMERGENCY REPAIR LIENS

By: Michael Treybich, Esq.

I recently had the opportunity to handle the case *380 Kings Highway LLC v. Fidelity National Title Insurance Company*[1], where the New York State Supreme Court, Kings County, found that the ALTA Owner's Policy (6/17/06) (the "Policy") was amended by the New York Standard Endorsement (Owner's Policy) (For ALTA 6/17/06)[2] (the "Endorsement") to cover a New York City emergency repair lien, despite the Endorsement not having been delivered at the closing, denied defendant's motion to dismiss, and granted my client's, the plaintiff's, cross-motion for summary judgment.

The plaintiff had purchased an interest in real property located at 380 Kings Highway, Brooklyn, New York (the "Property"). At the closing of title to the Property on February 12, 2009 (the "Closing"), the defendant issued the Policy insuring the title.

Prior to the Closing, on or before August 5, 2008, the City of New York had emergency work done at the Property to cure an allegedly dangerous condition (the "Work").

After the Closing, on January 4, 2010, the charges for the Work ripened into a lien against the Property superior to the interest of the plaintiff pursuant to a local code[3] (the "Lien").

The plaintiff gave notice of claim under the Policy and the defendant disclaimed coverage under one of the exceptions contained in schedule B of the Policy which states:

> "Emergency Repair Liens pursuant to the Administrative Code of the City of New York may have attached and not been filed with the County. No Liability is assumed for same."

The plaintiff brought a declaratory judgment action against the defendant and following joinder of issue, the defendant moved to dismiss the complaint based on this exception.

The plaintiff cross-moved for summary judgment based on the Endorsement, which states in pertinent part:

> "1. The following is added as a Covered Risk:
>
> '11. Any statutory lien for services, labor or materials furnished prior to the date hereof, and which has now gained or which may hereafter gain priority over the estate or interest of the insured as shown in Schedule A of this policy.'
>
> ***
>
> This endorsement is issued as part of the policy … To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls."

Despite not having been delivered at the Closing, the Endorsement was found to be incorporated into the Policy by reference, as the Policy states on the first page at the top that it is the "American Land Title Association Owner's Policy (6/17/06) with New York Coverage Endorsement Appended" and in the bottom right corner of every page that it is the "ALTA Owner's Policy (6/17/06) with New York Coverage Endorsement Appended".

The Court found that the plaintiff established that the Lien exists, is a statutory lien, the Work was furnished prior to the Closing, the charges for the Work was what ripened into the Lien, the Lien gained priority over the plaintiff's estate in the Property after the Closing, and hence was covered under the Endorsement.

The Court then looked at the Policy and the Endorsement and held that because the Endorsement language expressly covered the Lien and that the exception relied upon by the defendant was part of the Policy and was inconsistent with the Endorsement, the Endorsement controls, because "in construing an endorsement to an insurance policy, the [e]ndorsement and the policy must be read together, and the words of the policy remain in full force and effect except as altered by the words of the endorsement."[4]

---

1 33 Misc. 3d 1233(A); 946 N.Y.S.2d 69; 2011 N.Y. Slip Op 52223(U), 2011 WL 6182117 (Sup. Ct., Kings Cty., 2011).

2 As published in the Title Insurance Rate Service Association, Inc. (TIRSA) New York State Rate Manual, Fourth Edition of the Fourth Reprint.

3 New York City Administrative Code § 27-2144.

4 *County of Columbia v Continental Insurance Co*., 83 NY2d 618, 628 (NY Ct. of Appeals 1994)

Judgment for $117,206.25, the full amount of the Lien was granted to the plaintiff together with statutory pre-judgment interest of 9% per year[5] from the date of the notice of claim by the plaintiff.[6]

This was a case of second impression in New York and the first time it was reported that such a motion had been granted. In the prior case the court had denied the plaintiff's motion for summary judgment as the plaintiff failed to produce evidence of the "entry of the repair, or the purchase or work order for the repair, and the date such entry was made" in the records of the New York City Department of Housing Preservation and Development ("HPD").[7]

In this case, the evidence was obtained by the making of FOIL[8] requests for the appropriate certified documents to HPD and to the New York City Department of Finance.

Michael Treybich *is an associate attorney with Tsyngauz & Associates, P.C. in New York City, where his practice focuses on general commercial, real estate, construction and insurance coverage litigation and appeals in all of his practice areas. Michael is a member of the Editorial Board of the Brooklyn Barrister, where he co-authors the regular column "Survey of Verdicts and Settlements in Kings Supreme". Michael can be reached by telephone at (212) 337-9770 or by Email at treybich@nytlaw.com.*

5 NY CPLR § 5004.

6 NY CPLR § 5001.

7 Peretz Strahl, Inc. v. Fidelity National Title Insurance of New York, 9 Misc.3d 1110(A), 806 N.Y.S.2d 448, 2005 WL 2276028, 2005 N.Y. Slip Op. 51480(U) (Sup. Ct., Kings Cty., 2005)

8 New York Freedom of Information Law (Public Officers Law §87 *et. seq.*)

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MARYLAND APPELLATE COURT REJECTS VICARIOUS LIABILTY CLAIMS AGAINST TITLE INSURER

By: Richard E. Hagerty, *Troutman Sanders LLP*, McLean, Virginia

The Maryland Court of Special Appeals has rejected vicarious liability claims against a title insurer for the negligence of its agents relating to the status of title to insured property. *Columbia Town Center Title Co. v. 100 Investment Ltd. P'ship*, 203 Md. App. 61, 36 A.3d 985 (2012), is the first reported decision by a Maryland appellate court holding squarely that a title insurer's liability is limited to the terms of its policy.

The decision is the latest chapter in a dispute that has been litigated for over 10 years and which sparked 3 separate appeals. The court reversed a trial court's judgment against Chicago Title and its agents for $191,510.88 in damages arising out of October and December 1986 transactions in which Chicago Title or its predecessor, Safeco Title, underwrote two owner's title insurance policies in favor of a real estate development partnership. Both policies failed to except for the prior conveyance of a 1.145 acre parcel in an almost 50 acre assemblage of undeveloped property. In May 2009 the trial court entered judgment against the title agencies and Chicago Title, concluding that the agencies negligently failed to disclose the prior conveyance, that this negligence proximately caused the partnership's damages when it repurchased the 1.145 acre parcel in July 2001, and that Chicago Title was vicariously liable for its agents' negligence.

A 2-1 majority of the Court of Special Appeals held that the title agencies did not owe an independent tort duty to the partnership in connection with the issuance of the title insurance policies. The opinion was based in part on analysis of prior Maryland decisions, including *Corcoran v. Abstract & Title Co. of Maryland, Inc.*, 217 Md. 633, 143 A.2d 808 (1958) and *Watson v. Calvert Bldg. Ass'n*, 91 Md. 25, 45 A. 879 (1900), holding that a title examiner's duty of care in examining title is defined and limited by the terms of its contract with the party for whose benefit it is examining the title. The majority also distinguished *Jacques v. First Nat'l Bank of Maryland,* 307 Md. 527, 515 A.2d 756 (1986) and other Maryland decisions that have recognized a tort claim where the parties are in privity of contract but there is nevertheless an independent tort duty to exercise care based on an "intimate nexus" between the parties and circumstances such as specialized skill and knowledge or a legislative policy in favor of imposing extra-contractual duties. The majority opinion concluded that there was no statutory or other public policy basis on which to impose tort duties on title agents. "[T]he extension of tort liability to title companies in the absence of a separate agreement beyond the issuance of a binder and title insurance policy is more appropriately addressed by the General Assembly." *Columbia Town Center Title Co.,* 203 Md. App. at 86, 36 A.3d at 1000.

More significantly, the entire three-judge panel held that a title insurance underwriter is not vicariously liable for negligent title searches performed by its agents in connection with the issuance of title insurance policies. "To create a tort remedy for a negligent title search performed for the issuance of a title insurance policy would make the title insurer a guarantor of title and deprive the insurer of its option to cure the title or to pay for covered losses as contracted for in the title insurance policy." 203 Md. App. at 91, 36 A.3d at 1002. The court based its decision on several factors, including the agency agreements and the language of the title policy, which expressly limited claims for loss or damage arising out of the status of the title to the insured property, "whether or not based on negligence," to "the provisions and conditions and stipulations" of the policy. The court concluded that "[t]o permit an insured to sidestep the policy limitations through a claim of vicarious liability undermines the contractual agreement and potentially title insurance in general." 203 Md. App. at 102, 36 A.3d at 1009.

Unless reversed,[1] *Columbia Town Center Title Co.* puts Maryland squarely on the side of jurisdictions that construe title insurance policies as contracts of indemnity, therefore limiting a title insurer's liability to the terms of the policy. The decision could have important ramifications for property owners and lenders who wish to assert extra-contractual claims against title insurers who have underwritten policies on real property located in Maryland.

Richard E. Hagerty *is an Of Counsel in the McLean, Virginia office of Troutman Sanders LLP, where he represents title insurers in claims and coverage matters throughout the Metropolitan Washington area and the Mid-Atlantic. Mr. Hagerty can be reached at 703-734-4326 or richard.hagerty@troutmansanders.com.*

1 Appellees filed a timely petition for a writ of certiorari to the Maryland Court of Appeals, which is still under review.

Lawler v. Fidelity National Title Insurance Company: IN GOOD FAITH: A TITLE INSURER'S RIGHT TO PROSECUTE PRIOR TO PAYMENT

By: Dwayne Danner and Frank Catalano

In situations where a policy of title insurance imposes on the insurer the duty to indemnify an insured, the title insurer acts in good faith as long as it complies with the options provided it by the language contained in the title policy. More specifically, as recently held by the U.S. District Court for the Northern District of Texas, "where a policy of title insurance gives the insurer the right or duty to defend its insured against adverse claims to title, the insurer may take the opportunity to prosecute the action on the insured's behalf *before paying the claim*."[1]

In Lawler, Fidelity National Title Insurance Company ("Fidelity") issued a Texas Residential Owner Policy of Title Insurance ("Policy") in conjunction with Plaintiff's purchase of real property.[2] Subsequently, Plaintiff received a Notice to Vacate due to the alleged foreclosure of a previous tax lien on the property.[3] After Plaintiff received the Notice to Vacate, she submitted a claim under the title Policy and, without delay, Fidelity retained the law firm of Law, Snakard & Gambill, P.C. ("Law Snakard") to represent Plaintiff.[4] At the time, issues regarding funds placed in the registry of the court relative to the tax lien were being litigated in a Tarrant County state court lawsuit, thus Law Snakard intervened in the underlying lawsuit on behalf of Plaintiff in order to protect her title interests.[5]

Dissatisfied with Fidelity's course of action available under the terms of the Policy, Plaintiff filed suit against Fidelity alleging that the insurer breached its duty of good faith and fair dealing by refusing to pay the claim instead of litigating on behalf of the insured in the underlying lawsuit.[6] In her complaint, Plaintiff complained that Fidelity had not pursued the strategy suggested by Plaintiff and that Fidelity had not acquiesced to Plaintiff's demand that it settle with Plaintiff rather than proceed with the underlying litigation.[7] Plaintiff also asserted a breach of contract cause of action, claiming that Fidelity disregarded Plaintiff's right to disapprove of the choice of attorney for reasonable cause.[8]

Fidelity sought summary judgment on these issues arguing there were no genuine issues of fact that, under the terms of the Policy and Texas state law, Fidelity satisfied its obligations under the Policy by retaining counsel on behalf of Plaintiff to litigate any purported defect of title in Plaintiff's property. In its recitation of facts, the Court acknowledged specific language from the title Policy as follows:

4. OUR CHOICES WHEN YOU NOTIFY US OF A CLAIM

a. After we receive your claim notice or in any other way learn of a matter for which we are liable, we can do one or more of the following:

(1) Pay the claim against your title.

(2) Negotiate a settlement.

(3) Prosecute or defend a court case related to the claim.

(4) Pay you the amount required by this Policy.

(5) Take other action under Section 4b.

(6) Cancel this policy by paying the Policy Amount, then in force, and only those costs, attorneys' fees and expenses incurred up to that time that we are obligated to pay.

We can choose which of these to do.

5. HANDLING A CLAIM OR COURT CASE

You must cooperate with us in handling any claim or court case and give us all relevant information. We must repay you only for those settlement costs,

1 *Lawler v. Fidelity Nat. Title Ins. Co.*, Slip Copy, 2011 WL 5221261, *3 (N.D. Tex. Oct. 31, 2011); *see also* *Martinka v. Commonwealth Land Title Ins. Co.*, 836 S.W.2d 773, 776 (Tex.App.–Hous. [1 Dist.] 1992); *Southern Title Guarantee Co. v. Prendergast*, 494 S.W.2d 154, 156 (Tex. 1973).

2 *Lawler*, 2011 WL 5221261 at *1.

3 *Id.*

4 *Id.* at *2.

5 *Id.*

6 *Lawler*, 2011 WL 5221261 at *2.

7 *Id.*

8 *Id.*

> attorneys' fees and expenses that we approve in advance. When we defend or sue to clear your title, we have a right to choose the attorney. You have the right to disapprove our choice of attorney for reasonable cause. We can appeal any decision to the highest court. We do not have to pay your claim until your case is finally decided. We do not agree that the matter is a covered title risk by defending.[9]

The Court also recognized that a title insurance policy is a contract of indemnity that imposed upon Fidelity a duty to indemnify the insured.[10] Further, the duty to defend an insured is determined by the "eight corners rule," which requires the court to look solely at the allegations in the pleadings of the underlying lawsuit in light of the policy provisions, regardless of the truth of the allegations.[11] Under Texas law, insurance policies are "interpreted in accordance with the rules of construction that apply to all contracts generally."[12] Thus, "[t]o establish a breach of the Policy requires plaintiff to show the existence of a valid contract, performance by plaintiff, a breach by defendant, and damage to plaintiff."[13]

In light of Texas law governing insurance policies and given the terms of the Policy itself, the Court held that Fidelity had not breached either the terms of the Policy or its duty of good faith and fair dealing because it was "undisputed that defendant engaged counsel to prosecute a court case related to the claim, as expressly authorized by the Policy, and that counsel continued to prosecute the case at the time defendant filed its summary judgment motion."[14] The Court further reasoned that:

> When plaintiff submitted her claim to defendant, the applicable Policy language required defendant to take some action: pay the claim, negotiate a settlement, prosecute or defend a court case on the claim, or pay the Policy amount, among other options. The Policy expressly authorized defendant to determine which option to pursue. . . . Because defendant acted pursuant to the terms of the Policy, no breach occurred.[15]

The Court also addressed Plaintiff's claim that Fidelity breached the terms of the Policy because she allegedly disapproved of Fidelity's choice of counsel.[16] In support of this contention Plaintiff relied on letters to Fidelity and Law Snakard, which the Court summarized as letters that merely "request copies of pleadings; other letters stress that plaintiff is encountering financial difficulties and urge settlement of the State Court Action; and some suggest possible courses of action that could be taken, including urging defendant to settle with plaintiff."[17] The Court held that, while it appeared it was the intent of these letters to urge Law Snakard or Fidelity's in-house counsel to implement the strategy suggested by Plaintiff, none of the letters voiced disapproval of Law Snakard, nor did they ask that defendant appoint new counsel.[18]

As a result, the Court dismissed with prejudice Plaintiff's breach of good faith and fair dealing and breach of contract claims against Fidelity. In doing so, the Court reiterated that "a title insurance policy is a contract of indemnity" and that "the duty of a title insurance company to its insured is to indemnify the insured against a loss occasioned by a defect in title.[19] Thus, under the terms of the title insurance Policy issued to Plaintiff, Fidelity satisfied its duty of good faith and fair dealing by exercising the contractual right to intervene in the state court action on the insured's behalf and was "not required to pay plaintiff's claim" until the underlying case was finally decided.[20]

Dwayne Danner *and* ***Frank Catalano*** *are in McGlinchey Stafford, PLLC's Dallas office. Their practice focuses on consumer finance litigation and title insurance defense. Mr. Danner may be reached at 214.445.2408 or ddanner@mcglinchey.com. Mr. Catalano may be reached at 214.445.2411 or fcatalano@mcglinchey.com.*

9 *Lawler*, 2011 WL 5221261 at *1.

10 *Id.* at *4.

11 *Hanson Business Park, L.P. v. First Nat. Title Ins. Co.*, 209 S.W.3d 867 (Tex.App.—Dallas 2006); *GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church*, 197 S.W.3d 305, 308 (Tex. 2006); *Koenig v. First American Title Ins. Co. of Texas*, 209 S.W.3d 870 (Tex.App.–Houston [14 Dist.] 2006).

12 *Lawler*, 2011 WL 5221261 at *3; *citing Sharp v. State Farm Fire & Cas. Ins. Co.*, 115 F.3d 1258, 1260–61 (5th Cir. 1997) (*citing Nat'l Union Fire Ins. Co. of Pittsburgh, Pa. v. CBI Indus., Inc.*, 907 S.W.2d 517, 520 (Tex. 1995)).

13 *Lawler*, 2011 WL 5221261 at *3; *citing Lewis v. Bank of Am. NA*, 343 F.3d 540, 544–45 (5th Cir. 2003) (*citing Palmer v. Espey Huston & Assocs., Inc.*, 84 S.W.3d 345, 353 (Tex.App.—Corpus Christie 2002, pet. denied).

14 *Id.* at 3.

15 *Id.* at 3.

16 *Id.* at 3-4.

17 *Lawler*, 2011 WL 5221261 at *4.

18 *Id.*

19 *Id.* at *4; *citing Chicago Title Ins. Co. v. McDaniel*, 875 S.W.2d 310, 311 (Tex.1994) (per curiam).

20 *Id.* at *5.

WASHINGTON COURT REFINES DOCTRINE OF EQUITABLE SUBROGATION

By: Thomas A. Ped, *Williams Kastner & Gibbs PLLC* *(Portland, Oregon)*

The doctrine of equitable subrogation is a remedy that generally applies to avoid an unearned windfall at the expense of another. Equitable subrogation may apply when one pays or performs in full an obligation owed by another that is secured by a mortgage. In *Columbia Community Bank v. Newman Park LLC*, 2012 Wn. App. LEXIS 360 (Div. 2, February 22, 2012), the Washington Court of Appeals clarified and confirmed the "volunteer" rule does not bar application of the doctrine under the *Restatement (Third) of Property: Mortgages § 7.6(a)* (1997). The case provides further assurance that lenders who pay off prior mortgages will be subrogated through the equitable doctrine to the prior lienholder's lien position, but only in the amount of the payoff.

Columbia Community Bank involved loans made to Joseph Sturtevant. In 2004, Sturtevant formed Newman Park LLC. Another Sturtevant company, Landmark Development Ventures, Inc., was one of 12 members and a 39 percent owner of Newman Park. The other members collectively owned 61 percent. Sturtevant was personally not a member of the company, but was described as the "manager" in its operating agreement. In December 2004, Newman Park purchased land for $500,000 to develop a residential subdivision. The purchase was financed with a $393,100 loan from Hometown National Bank, which was secured by a deed of trust granted by Newman Park against the title to the property.

Sturtevant formed yet another company, Trinity Development-Northwest LLC, in October 2007, for which he sought a loan from Columbia Community Bank. Sturtevant proposed to pledge the Newman Park property as security and falsely represented to Columbia that Landmark was the sole owner of Newman Park. Columbia approved a loan of $1.5 million loan prior to reviewing any corporate documents. Eventually, Sturtevant produced an altered copy of Newman Park's operating agreement showing Landmark as the only member. The obligation to Columbia was secured by a deed of trust against the title to Newman Park's property granted by Landmark. Columbia's funds paid off the entire Hometown loan and delinquent property taxes. The record from the lower court showed no other member of Newman Park LLC was aware of or approved the Trinity loan transaction,

Trinity defaulted on the loan. When Columbia attempted to foreclose on its deed of trust, it learned about possible problems with Sturtevant's authority to obtain the loan. Columbia filed a complaint for a judgment declaring its deed of trust on the property was valid and enforceable. In the alternative, it sought to be placed in Hometown's first lien position security interest under the doctrines of equitable subrogation and unjust enrichment. Newman Park LLC filed a separate suit seeking a declaration that the deed of trust was invalid and unenforceable. Following consolidation of the actions, the parties filed motions for summary judgment.

The trial court granted Newman Park's motion, ruling that because Newman Park's operating agreement named Sturtevant as its manager, Landmark did not have authority to pledge the property as security. The court rejected Columbia's claims based on apparent authority as well. Columbia then moved for summary judgment to establish its rights through equitable subrogation or unjust enrichment, which was granted.

On appeal, Newman Park argued equitable subrogation did not apply because Washington law limits equitable subrogation to mortgagees competing for priority, and Columbia was not a priority creditor. Newman Park further argued Columbia was not entitled to relief because it volunteered to make the loan. The Court of Appeals noted the Washington Supreme Court recently adopted *Restatement (Third) of Property: Mortgages § 7.6(a)* (1997), which describes equitable subrogation as:

> One who fully performs an obligation of another, secured by a mortgage, becomes by subrogation the owner of the obligation and the mortgage to the extent necessary to prevent unjust enrichment. Even though the performance would otherwise discharge the obligation and the mortgage, they are preserved and the mortgage retains its priority in the hands of the subrogee.

Bank of Am. v. Prestance Corp., 160 Wn.2d 560, 564, 160 P.3d 17 (2007).

The Court rejected Newman Park's contention that equitable subrogation applies only to "creditors' priority disputes," holding that the examples from the *Restatement* demonstrate the doctrine applies even when a mortgagee pays off the only existing mortgage, and the question is not one of priorities but whether the new mortgagee steps into the shoes of the paid-off mortgagee. The Court noted the doctrine applies even where one person encumbers the property of another but without authority to do so, and misuses some of the loan proceeds. The remaining owner is not entitled to be enriched by getting the property debt free.

The Court also held that equitable subrogation is available for one who voluntarily pays off a prior mortgage holder. In an earlier decision, the Division Two court had applied the "volunteer" rule to defeat application of the doctrine, on the grounds that a lender who pays off a prior encumbrancer, without legal compulsion and with knowledge of an intervening lienholder, would itself be unjustly enriched by being equitably subrogated to the first lienholder's position. *BNC Mortg., Inc. v. Tax Pros, Inc.*, 111 Wn. App. 238, 255-56, 46 P.3d 812 (2002). In light of the Washington Supreme Court's subsequent adoption of the *Restatement*, which rejects the volunteer rule, the Court of Appeals held the rule is no longer a defense.

Although Columbia could be equitably subrogated to Hometown's lien position, the deed of trust itself could not be reinstated. The Court further found the deed of trust was invalid as a matter of law since Landmark was not an agent of Newman Park. Columbia's contention that it properly relied upon Sturtevant's and Landmark's apparent authority to act on Newman Park's behalf was rejected, because the evidence showed Columbia agreed to make the loan before reviewing any falsified documents. Consequently, although Columbia prevailed under equitable subrogation, Newman Park prevailed as to the validity of the deed of trust, so that Columbia could not recover its attorney fees as provided for in the instrument.

Columbia Community Bank provides clarification for lenders who are determined after-the-fact to have volunteered; the rule will not defeat application of equitable subrogation in Washington. The case also is a cautionary tale: if the deed of trust is determined not to be valid and enforceable, attorney fees cannot be recovered.

Thomas A. Ped *is a member of Williams, Kastner & Gibbs PLLC, in its Portland, Oregon office. He practices with the Title Insurance Group, regularly handling claims litigation for underwriters, agents and insureds.*

EXCEPTIONS CAN SAVE…

Continued from page 1

the rights granted by the previously recorded easements. The Partial Release and the easements were of record in the Register of Deeds Office, however, unlike the easements, the Partial Release had not been included in the exception section of the title insurance policy.

When G.C. Finance refused Columbia Gulf's request to enter the property to upgrade the gas transmission lines, Columbia Gulf brought suit against G.C. Finance in State Court to gain declaratory and injunctive relief and damages. Columbia Gulf's suit referred to its rights under the easements and the Partial Release. G.C. Finance then tendered the defense of the suit to Old Republic claiming the Partial Release was a defect and/or encumbrance not specifically listed as an exception under the title insurance policy. Thus, according to G.C. Finance, Old Republic had a duty to defend and possibly indemnify G.C. Finance. Old Republic refused the tender.

Columbia Gulf won at the trial Court and the Court of Appeals affirmed. Thereafter, the pipelines were dug up and the lines repaired. G.C. Finance filed suit against Old Republic for indemnification for the defense costs of over $300,000.00 and damages to the golf course of more than $1,000,000.00.

In defense of the lawsuit, Old Republic asserted that the easements provided all the rights claimed by Columbia Gulf and the easements were listed as exceptions in the policy. Further, Old Republic argued the Partial Release had the effect of diminishing Columbia Gulf's rights under the easements and thus was not a lien, defect or encumbrance on the property that would trigger a duty to defend or indemnify G.C. Finance.

On competing summary judgment motions, the United States District Court for the Middle District of Tennessee first ruled that there was coverage requiring Old Republic to defend G.C. Finance in the underlying case. Old Republic quickly filed a motion to alter or amend the findings arguing that the Court committed a clear error of law by not reviewing the instruments to

determine whether the Partial Release was a lien and/or encumbrance. The Court reversed itself and entered judgment in Old Republic's favor. The Court concluded that the Partial Release, as the name suggested, released the rights granted by the easements to Columbia Gulf. As a result, the Court found that the Partial Release did not decrease the value of the property but enhanced it. Thus, the Partial Release was not an encumbrance, which the Court defined as: "'Encumbrance' as 'claim or liability'…that may lessen its value". Consequently, the Court found that the Partial Release did not trigger Old Republic's duty to defend. G.C. Finance appealed.

Before the Court of Appeals was one issue: "Did the title policy obligate Old Republic to defend G.C. Finance in the underlying state court litigation?" Noting that the duty to defend turns on the allegations made in the Complaint, the Court held that "At the end of the day, it is the [easement] that furnishes Columbia with the right to access the golf course and upgrade the pipelines and the insurance policy excludes that easement from coverage." The Court affirmed and stated that G.C. Finance could not saddle the insurance company with the defense of lawsuit based on G.C. Finance's decision to deny Columbia Gulf's rights under the easement.

Though this opinion provides some clarification on the definition of a lien or encumbrance, the case also demonstrates the importance of the policy's exceptions section. When in doubt, list it.

David B. Herbert *is of counsel with the Firm of Ortale, Kelley, Herbert & Crawford.* ***Thomas C. Corts*** *is senior partner with the Firm of Ortale, Kelley, Herbert & Crawford.* ***Will Caldwell*** *is an associate with the Firm. Each of these lawyers handle extensive insurance matters in litigation representing insurance companies in both State and Federal Courts in Tennessee. These lawyers can be reached at (615) 256-9999 or at the following e-mail addresses: dherbert@ortalekelley.com; tcorts@ortalekelley.com; wcaldwell@ortalekelley.com.*

TENDER OF LOSS…

Continued from page 6

that duty by tendering the policy limits. However, the 1966 title policy in Kent School differs from the 1992 and 2006 ALTA policy forms and the Batdorf policy in key respects. The cover sheet of the Kent School policy stated that it insured

> "against all loss or damage not exceeding the amount of insurance stated herein **and in addition** the costs and expenses of defending the title, estate or interest insured. . ."

Id. at 8.

The court read this provision – especially the phrase "and in addition to" – as specifically separating loss under the policy from the cost and expenses of defending the title and indicating two separate obligations under the policy.

Section Two (a) of the subject policy in Kent School, which contained the duty to defend, also made no mention of the option to tender the loss under the policy. In contrast, the corresponding sections of the 1992 ALTA policy form, Section 4(a), and the 2006 ALTA policy form, Section 5(a), specifically state that the obligation to defend is subject to the title company's exercise of its options under the policy to pay or otherwise settle claims.

In addition, Section Five(b) of the Kent School policy concerning tender of a loss made no mention of the duty to defend and simply stated that the Company "may terminate its liability hereunder by paying or tendering the full amount of this Policy." That section of the Kent School title policy went on to provide that the title insurer "may, without conceding liability, demand a valuation of the insured estate or interest…" The court read this provision to limit the definition of the term "liability" to monetary liability for a claim under the indemnity portion of the policy with no connection to the duty to defend. Again, in contrast, Section 6(a) of the 1992 ALTA policy form and Section 7(a) of the 2006 ALTA policy form concerning the tender of the loss specifically and clearly provide for the termination of the obligation to defend.

First American Title Ins. Co. v. Grafton Partners, LLC, 2009 WL 792263 (D. Mass.), involved the defense of an adverse possession claim to a portion of a supermarket lot and a zoning challenge to the subsequent modification of the site plan and the prosecution of a claim for malpractice against a surveyor. First American refused to defend the zoning challenge and prosecute the malpractice action. First American also appraised the value of the small piece of land that was subject to the adverse possession claim, tendered a check for that value, $26,300, to the insured and sought a declaratory judgment that its duty to defend had been terminated. The parties eventually brought cross-motions for summary judgment. In addition to ruling that the title

insurance policy did not require the insured to defend the zoning dispute or to prosecute the claim against the surveyor, the court ruled that First American had not terminated its liability under Section 6(a) of the 1992 ALTA policy. The court, however, did not reach the question of whether the duty to defend was terminated under the partial loss provisions of Section 6(b)(ii) of the policy and called for further evidence and briefing on the issue of whether the tender of the $26,300 constituted the loss under the policy. Ultimately, the court did not address that issue because the case was settled.

Two more recent cases on this issue both involve Stewart Title and yield mixed results. Mortensen v. Stewart Title Guaranty Co., 235 P. 3d 387 (Ida. 2010), and Fleishour v. Stewart Title Guaranty Co., 743 F. Supp. 2d 1060 (E.D.Mo. 2010). Mortensen arose out of an access dispute. An abutter sued the insured for trespass, negligence and quiet title, asserting that the insured did not have an easement across its land to a public road. Stewart Title provided counsel to defend the insured on all of the claims. After trial and multiple appeals, the Idaho Supreme Court ruled that the insured had a prescriptive easement, but remanded the case for a further trial on the exact location of the easement and a redetermination of damages. At that point Stewart Title gave up the ghost, tendered the full amount of the policy, $200,000, and terminated the defense. The insured sued Stewart Title for breach of contract. In that coverage action, the Idaho Supreme Court affirmed summary judgment for Stewart Title, reasoning that the insured is entitled to recover only up to the amount of the policy and that the insurer fulfills it duties by tendering the full value of the policy. The court also ruled that the policy language (the policy appears to be a 1992 ALTA policy) plainly and unambiguously permitted the title insurer to pay the policy limit rather than pursuing the litigation.

Fleishour, which involved a partial loss, did not turn out as well. That case arose out of a claim by the insureds' abutter that it had adversely possessed a 1,100-square-foot triangle of the insureds' land. An appraiser estimated the diminution in value at $1,000 and Stewart Title tendered that amount to the insureds who refused it. Stewart Title declined to defend the adverse possession claim which the insureds subsequently lost. The insureds then sued Stewart Title for breach of contract. Following trial, the federal district court entered judgment for the insureds. The court ruled that Stewart Title did not have the option to pay the amount of the insureds' loss because the insureds did not sustain any actual loss under the policy – a contract of indemnity – until the underlying suit was concluded. Id. at 1069-1070. In other words, the title insurer could not pay the loss and thereby terminate its duty to defend when the insured had not yet sustained a loss.

The Fleishour court also noted that, under Missouri law, the duty to defend was broader than the duty to indemnify and that Stewart Title's interpretation of the policy would shift the risk of litigation to the insureds and would yield an "absurd" result because a title insurer would defend only cases that had no merit and in which the anticipated litigation costs were less than the insureds' anticipated loss. The court's interpretation of the policy, however, renders the provisions concerning tender of loss and termination of defense and other obligations meaningless. In the most recent case on this issue, Toste v. First American Title Ins. Co., 2012 WL 1023360 (Cal. App. 3 Dist.) (unpublished), which arose out of a dispute between litigious and cantankerous insureds and their neighbors over an access easement across the insureds' land, the California Court of Appeal did give weight to these provisions. The court affirmed summary judgment for First American and held that First American's payment of a $54,000 loss on the claim, ended First American's obligation to defend including the appeal of the adverse judgment against the insureds. ⚖

Lawrence Heffernan is a partner at the firm Robinson & Cole, LLP. He is their chair of the Real Estate Litigation and Title Insurance Group and focuses on litigation in the real estate, title insurance, commercial, and banking arenas. He has extensive trial and appellate experience in cases involving complex real estate issues, development, fraud, insurance coverage, and corporate disputes. Mr. Heffernan is a frequent speaker before bar and business groups across the country.

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Speaker Contact: Donald Quarles – 312/988-5708

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November 2012

7-9 **Fidelity & Surety Committee Fall Meeting** — **Marriott Hartford Downtown, Hartford, CT**
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23- 25 **Fidelity & Surety Committee Midwinter Meeting** — **Waldorf-Astoria Hotel, New York, NY**

February 2013

6-12 **ABA Midyear Meeting** — **Hilton Anatole, Dallas, TX**
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14-16 **Insurance Coverage Litigation Spring CLE Meeting** — **Arizona Biltmore Resort & Spa, Phoenix, AZ**
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April 2013

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