

FORECLOSURES AND DEEDS IN LIEU OF FORECLOSURE –
LOAN POLICY INSURING THE DEED OF TRUST COMPARED TO NEW OWNER’S POLICY

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1. What a loan policy covers and does not cover regarding post – Date of Policy foreclosure

We will refer to the ALTA loan policy (10-17-92) as the 1992 loan policy or the 1992 policy. We will refer to the ALTA loan policy (6-17-06) as the 2006 loan policy or the 2006 policy.

EXAMPLE 1:

L's deed of trust is recorded on January 5, 2009 at 3:00 P.M. *L*'s loan policy is issued with that date and time as the Date of Policy. On September 5, 2009 *L*'s deed of trust is foreclosed. At the end of the foreclosure, a trustee's deed to *L* is recorded, *L*'s loan policy, whether it is a 1992 policy or a 2006 policy, continues to insure *L* after *L* acquires title at foreclosure. See the 1992 policy's Conditions and Stipulations ("C & S"), section 2 (a), and the 2006 loan policy's Conditions, section 2. However, the continued coverage is as of the Date of Policy, the date and time of the recording or the insured deed of trust. If *L* does not purchase a new owner's policy with the Date of Policy identical to the recording of the trustee's deed to *L*, *L* faces the following significant shortcomings in relying upon *L*'s loan policy:

1. Any defects in the post – Date of Policy foreclosure are not covered. See Exclusion From Coverage 3(d) (both 1992 and 2006 policies).
2. Failure of *L* to give notice the United States holding an inferior federal tax lien filed more than 30 days before the foreclosure sale is not covered. See 26 U.S.C § 7425. Failure to give lien subordinate lien holders filing a request for notice under G.S. 45-21.17 (4) and G.S. 45-21.17A or due to constitutional law principles is not covered.
3. Post-Date of Policy advalorem taxes and assessments having "super-priority status" are not covered and are not extinguished by *L*'s foreclosure. See G.S. 105-355 and G.S. 105-356 (taxes) and G.S 160A-233 and G.S. 153A -200 (assessments).
4. There may be valuation problems under a loan policy that do not exist under an owner's policy as discussed below.

In *CMEI, Inc. v. American Title Insurance Company*, 447 So.2d 427 (Fla. 5th D.C.A 1984), a Florida case involving an easement instead of a lien, the court held that there was no compensable loss or damage, drawing a distinction between an owner's policy and a loan policy. The court stated that under an owner's policy, the owner is entitled to be compensated for the full amount by which his full value is diminished by the defect or encumbrance as long as the amount of diminution is less than the amount of insurance, even if the diminished value of the land exceeds the amount of insurance. Under a loan policy, the same would not be true since, if the lender acquires title to land worth more than the amount of insurance and the outstanding indebtedness even with the defect that was not excepted from coverage, the debt will be repaid and the insured security for the debt will not be reduced in value, the court noting that such a rule applies to outstanding liens as well as easements. In *CMEI*, the court stated that when an insured lender acquires title, he continues to be an insured but the loan policy is not converted to an owner's policy. The discussion seems to imply that while the land is the security, the value of the mortgage is the key. See *Goode v. Federal Title Insurance Corp.*, 162 So. 2d 269 (Fla.2d D.C.A. 1964); *Ring v. Home Title Guaranty Co.*, 168 So. 2d 580 (Fla. 3rd D.C.A. 1964), cited in *CMEI*. Also, see *First Commerce Realty Investors v. Peninsular Title Ins. Co.*, 355 So. 2d 570 (Fla. 1st D.C.A. 1978).

In a 1931 Virginia case, *Title Insurance Co. of Richmond v. Industrial Bank of Richmond*, 156 Va. 322, 157 S.E. 710 (1931), the court reached a result opposite to that reached by the court in *CMEI*. While the Virginia case could not have involved the 1992 ALTA loan policy form, there is no indication in the Virginia case that the loan policy involved was different from the policy in the *CMEI* case, especially in regard to the noticeable policy failure to define the phrase "loss or damage." In the case, the court held that the insured lender was entitled to compensation under the loan policy for the diminution in value due to the existence of a prior lien not excepted to in the policy even though the insured lender received more than the outstanding loan balance when the insured lender sold the land.

Compare *Blackhawk Production Credit Ass'n v. Chicago Title Ins. Co.*, 135 Wis. 2d 324, 400 N.W. 2d 287 (Ct. App. 1986), reversed, on other grounds, 144 Wis. 2d 68, 423 N.W. 2d 521 (1988).

As to this issue, the 1992 policy's C&S, sections 2(a), 7 and 9 should be consulted. In the 2006 policy, the Conditions, sections 2, 8 and 10 should be reviewed. It was not absolutely clear that the *CMEI* case would be followed under the 1992 policy. There is no indication that the 2006 policy was intended to be different from the 1992 policy in this regard. And, prior to that, there was no indication that the 1992 policy attempted to expressly clarify or change the 1970 policy in this regard. R. Jordan, *ALTA Forms Committee Revises Title Insurance Policies, Title Insurance – The new Policy Changes*, 127 at 138-141 (PLI 1987), discussing an earlier version of the 1992 policy. However, the 1992 policy's C&S section 7(a)(ii) and the 2006 policy's Conditions section 8(a)(ii), where the indebtedness is the least of three measures of loss that can be paid, seem determinative in favor of the title injurer. In the loan 2006 policy, "indebtedness" is defined in paragraph 1(d) of the Conditions.

2. Assignment Of Bid And Title Winding Up In An Entity Related To The Insured Lender

Consider a slightly different twist we have been asked about, raising related issues.

EXAMPLE 2:

L's deed of trust recorded on January 5, 2009 at 4:50pm is insured by a loan policy bearing that recording data as the Date of Policy. *L* forecloses on December 5, 2009: *L* assigns *L's* bid to *X*, an entity related to *L*. The trustee's deed goes to *X*.

This raises issues as to who can be an "insured." That is governed by the Conditions and Stipulations ("C&S") of the 1992 policy and by the Conditions of the 2006 policy.

(a) 1992 Loan Policy continuation of coverage

"Insured" includes *L* when *L* is the holder of the insured deed of trust and secured indebtedness at Date of Policy and after. It also covers the "owner of the indebtedness secured by the insured" deed of trust. C&S section 1(a)(i). This covers the assignee of the indebtedness via assignment of the note. After foreclosure as in EXAMPLE 2 there is no "owner of the indebtedness secured by the insured" deed of trust, since when the foreclosure is finalized, there is no deed or trust. See C&S section 2(a)(i) – if *L* gets the trustee's deed after Date of Policy, *L's* coverage is continued as of Date of Policy. *X* is not covered. See C&S section 2(a)(ii) – if *L* is covered under C&S section 2(a)(i), and *L* is a corporation, *X* is covered if *X* is the parent of *L* or a wholly owned subsidiary of *L* if *L* conveys to *X*. But, in EXAMPLE 2 above, *L* is not covered because *L* did not get the deed and so, *X* cannot be covered. See C&S section 2 (b), which does not apply.

(b) 2006 Loan Policy continuation of coverage

"Indebtedness" is the "obligation secured by the insured" deed of trust, under Conditions, section 1(d). "Insured" is defined in Conditions, section 1(e). 1(e)(i)(A) does not cover *L* after foreclosure in the Example 2 above since *L* no longer owns the indebtedness secured by the deed of trust – the deed of trust is gone. 1(e)(i)(B), (C) and (D) obviously do not apply. 1(e)(i)(E) does not apply since there is no deed from *L* to *X*. Conditions, section 2 does not apply for obvious reasons.

It is worth setting forth the provisions of the Conditions of the 2006 loan policy definition of "insured" in section 1(e) to the extent they are cited above:

(e) "Insured": The insured named in Schedule A.

(i) The term "insured" also includes

(A) the owner of the indebtedness and each successor in ownership of the indebtedness, whether the owner or successor owns the indebtedness for its own account or as a trustee or other fiduciary, except a successor who is an obligor under the provisions of Section 12(c) of these Conditions:

(B) the person or Entity who has "control" of the "transferable record," if the Indebtedness is evidenced by a "transferable record," as these terms are defined by applicable electronic transactions law;

(C) successors to an Insured by dissolution, merger, consolidation, distribution, or reorganization;

(D) successors to an Insured by its conversion to another kind of Entity;

- (E) a grantee of an Insured under a deed delivered without payment of actual valuable consideration conveying the Title
- (1) if the stock, shares, memberships, or other equity interests of the grantee are wholly-owned by the named insured,
 - (2) if the grantee wholly owns the name insured, or
 - (3) if the grantee is wholly-owned by an affiliated Entity of the named Insured, provided the affiliated Entity and the named Insured are both wholly-owned by the same person or Entity.

While these provisions are to an extent an improvement and an addition to the 1992 policy, they do not obviate the necessary of obtaining a new owner's policy.

3. Deed in lieu of foreclosure

A deed in lieu of foreclosure raises similar coverage issues. In EXAMPLE 1 and EXAMPLE 2 above, if *L* takes a deed in lieu of foreclosure, C&S section 2(a)(i) of the 1992 loan policy continues coverage for *L* as of the Date of Policy – the date and time of the deed of trust's recording, not the recording of the deed in lieu. Section 2 of the Conditions of the 2006 loan policy does the same. Under either policy, post- Date of policy defects, liens and encumbrances are not covered, including bankruptcy problems with the deed in lieu and, for example, unfilled "mechanics' and materialmen's liens" for claimants furnishing lienable performance *after* the recording of the deed of trust and *prior* to the recording of the deed in lieu.

If the deed in lieu is taken by *X*, *X* is *not* covered by the loan policy, since *X* did not acquire title from *L*. This is true even if *X* is a parent or wholly owned subsidiary of *L* and *L* is an insured corporation. The same appears to be true under the 2006 loan policy's Conditions, sections 1(e) and 2. Therefore, once again, a new owner's policy should be obtained for the grantee in the deed in lieu.

4. Get an owner's policy

Obtaining a 2006 ALTA owner's policy insuring the recipient of the foreclosure trustee's deed with the Date of Policy through the date and time of recording will insure the state of title, including the period between the Date of Policy of the prior loan policy (the recording of the deed of trust) and the recording of the trustee's deed. In a deed in lieu of foreclosure situation discussed in 3 above, a new owner's policy should also be obtained. Under the North Carolina Title Insurance Rating Bureau, the new policy qualifies for reissue rate treatment.