

***Nationwide Life Insurance Company v. Commonwealth Land Title Insurance Company:
What steps must an insurer take to make certain restrictions “expressly excepted” from
coverage when an ALTA 9 Endorsement is issued?***

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Introduction

In a recent United States Court of Appeals Case, the Third Circuit addressed what steps a title insurer must take to except certain restrictions from coverage when an ALTA 9 Endorsement is issued.² In holding that to expressly except a restriction found in paragraph 1(b)(2) of the endorsement, a title insurer must list the *actual restriction* in Schedule B, the Court has opened the door for a multitude of questions regarding how specific title insurers will need to be to ensure that the restriction is in fact expressly excepted.

Factual Background

In *Nationwide Life Insurance Company v. Commonwealth Land Title Insurance Company* (2009) 579 F.3d 304,³ PMI Associates, (“PMI”) purchased real property located in Pennsylvania from Liberty Mills Limited Partnership (“Liberty Mills”) in 1988 (the “Property”).⁴ PMI and Liberty Mills entered into a Declaration of Restrictions. (*Id.* at 306.) The Declaration of Restrictions provided Liberty Mills, among other things, with the right to refuse approval of future purchasers of the Property. (*Id.* at 306.) Three years after purchasing the Property, PMI borrowed \$3.5 million dollars from Nationwide Life Insurance Company (“Nationwide”) using the Property as collateral. (*Id.* at 306.) Nationwide insured its interest in the Property by purchasing a 1992 ALTA Loan Policy with an ALTA 9 Endorsement.⁵ (*Id.* at 306.)

Schedule B to Nationwide’s policy listed a number of instruments that affected the Property.⁶ (*Id.* at 309.) Part I of Schedule B set out matters that were excepted from coverage that might cause loss to Nationwide and Part II listed matters affecting the Property that were subordinate to Nationwide’s interest. The Declaration of Restrictions was listed in Part I of Schedule B which stated “[t]his policy does not insure against loss or damage...which arise by reason of: ... 5. Declaration of Restrictions between Liberty Mills Limited Partnership and PMI

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² The Third Circuit Court of Appeals has appellate jurisdiction over the following district courts: District of Delaware, District of New Jersey, Eastern District of Pennsylvania, Middle District of Pennsylvania, and the Western District of Pennsylvania. (*See* The Third Circuit Court of Appeals website, available at <http://www.ca3.uscourts.gov/> (last visited December 2, 2009.))

³ An order amending this opinion was published as 2009 WL 3818849 (C.A.3 (Pa.)). The order amending the opinion clarifies a citation on page 31, footnote 14.

⁴ Notably, this case arises in Pennsylvania, where in 1876, the first title insurance company was founded. (ALTA, Title Insurance Primer Brochure.)

⁵ For a general discussion of the ALTA 9 Endorsement (the CLTA Form 100.2) see 3 Miller Starr, Cal. Real Estate (3d ed. 2000) § 7:118, p.7-248 to 7-249; *See also*, Joyce D. Palomar, 1 Title Insurance Law §§ 5.17-9.4 (2005).

⁶ The policy that was issued to Nationwide contained: the general insuring provisions which stated the basic coverage terms, the exclusions from coverage which listed standard coverage exclusions, the conditions and stipulations which defined relevant terms and noted the parties’ responsibilities, Schedule A which described the Property and the amount of insurance, and Schedule B which listed in two parts the coverage exceptions specific to the Property. (*Id.* at 308.)

Associated dated August 15, 1988 and recorded in....” Thus, there was no question that the Declaration of Restrictions was an exception from coverage contained in Schedule B. (*Id.* at 309.) Paragraph 1(b)(2) of the ALTA 9 Endorsement to the Nationwide policy read in part:

“The Company insures the owner of the indebtedness secured by the insured mortgage against loss or damage sustained by reason of: 1. The existence at Date of Policy of an of the following...(b) *Unless expressly excepted in Schedule B...* (2) Any instrument referred to in Schedule B as containing covenants, conditions or restrictions on land which, in addition, (i) establishes an easement on the land; (ii) provides a lien for liquidated damages; (iii) provides for a private charge or assessment; (iv) provides for *an option to purchase, a right of first refusal or the prior approval of a future purchaser or occupant.*” (*Id.* at 309.)

PMI defaulted on its loan and conveyed the Property to Nationwide in 2003. (*Id.* at 306.) Nationwide attempted to sell the Property to Ironwood Real Estate, LLC (“Ironwood”). However, the successor-in-interest to Liberty Mills, Franklin Mills Associates Limited Partnership (“Franklin Mills”) refused to approve of the sale in accordance with the rights afforded to it in the Declaration of Restrictions. (*Id.* at 306.)

Nationwide submitted a claim for coverage to Commonwealth alleging that Franklin Mills’ rights of refusal were covered restrictions that made the Property unusable and unsalable. (*Id.* at 307.) Commonwealth denied coverage stating that its policy expressly excepted coverage for loss arising from Franklin Mills’ rights of refusal. (*Id.* at 307.)

District Court

Nationwide filed suit arguing that the ALTA 9 Endorsement to its policy covered the loss resulting from Franklin Mills’ rights of refusal because those rights were not expressly excepted in the policy’s schedule of exceptions. (*Id.* at 307.) Commonwealth filed a motion to dismiss asserting that the rights were expressly excepted from coverage provided by the ALTA 9 Endorsement because the Declaration of Restrictions, in which the rights were stated, was listed in the policy’s schedule of exceptions. (*Id.* at 307.)

The District Court granted Commonwealth’s motion to dismiss and held that the general listing of the Declaration of Restrictions under the heading “exceptions from coverage” in the policy’s exceptions schedule “unambiguously eliminated coverage for loss stemming from the rights of refusal.” (*Id.* at 307.) Nationwide filed a motion for reconsideration. (*Id.* at 307.) The District Court denied Nationwide’s motion for reconsideration and stated that it was Nationwide’s duty to exercise proper diligence before issuing the mortgage. (*Id.* at 307.)

Third Circuit

On appeal, Commonwealth argued that loss arising from the Declaration of Restrictions was “expressly excepted” in Schedule B and therefore was not covered by paragraph 1(b)(2) of the ALTA 9 Endorsement. Specifically, Commonwealth asserted that Schedule B’s two-part structure provided that Part I contained “exemptions” from policy coverage and Part II contained the prioritization of liens. (*Id.* at 310.) Commonwealth argued that items in Part I were “expressly excepted” from coverage because they were the only “exceptions from coverage” in the policy, whereas the instruments in Part II were within the coverage of the Endorsement

because they were referred to in Schedule B, but not expressly excepted in Schedule B. (*Id.* at 310.)

Nationwide argued that the loss resulting from the Declaration of Restrictions was covered by the ALTA 9 Endorsement because the rights of refusal stated within it were not *specifically mentioned* in Schedule B. (*Id.* at 310-311 (emph. added).) Nationwide further argued that both parts of Schedule B contained exceptions from coverage and that exceptions to the ALTA 9 endorsement are not made merely by listing a document in Schedule B, but instead by specifically referring to and excepting the covenant, condition, or right in question. (*Id.* at 311.)

In reversing the District Court’s ruling and holding that Nationwide was covered for loss arising from the rights of refusal contained in the Declaration of Restrictions and that Nationwide did not bear the burden of diligence to ensure that its title to the Property was free from harmful rights of restrictions, the Court evaluated the text of the policy with the custom and practice of the industry. (*Id.* at 311.)

Specifically, the Court compared the ALTA 9 Endorsement to the ALTA 9.1 Endorsement and stated that with the ALTA 9.1 Endorsement, an insurer must distinguish between those Schedule B matters that are merely “exceptions from coverage” to which the ALTA 9.1 Endorsement applies, and those that are “expressly excepted” from all coverage. (*Id.* at 311-312.) Applying similar methodology, the Court stated that the ALTA 9 Endorsement covered loss from an instrument in either part of Schedule B unless the insurer took express exception to the specific restriction stated in the instrument. (*Id.* at 312.)

Notably, the Court emphasized industry custom and practice with respect to the purpose of the ALTA 9 Endorsement. (*Id.* at 314-315.) The Court cited both industry guidelines for the ALTA 9 Endorsement and leading scholars, including Jim Gosdin and Joyce Palomar. (*Id.* at 314-315.)

The Court further held that Nationwide did not bear the burden of completing proper diligence to ensure that the Declaration of Restrictions did not contain restrictions harmful to its interest in the Property. (*Id.* at 319.) The Court reviewed a LandAmerica article that the District Court had cited to support its holding that Nationwide had the burden of completing proper diligence. (*Id.* at 317.) The article read in pertinent part,

“Paragraph 1(b)(2) insures the lender that a document, described only as containing restrictions, doesn’t contain a grant of easement, a lien for liquidated damages, a private charge or assessment, an option, a right of first refusal or a right for prior approval of a future purchaser or occupant... Paragraph 1(b)(2) is found under paragraph 1(b) because an exception that fully describes the features of a document kills the coverage. The Insured will not be misled by an exception that discloses the features of a recorded instrument. If the exception has incomplete disclosure, the lender must review all of the recorded documents for an opinion that none contains a provision that might harm it.”

In reviewing this passage, the Court noted that (1) an insurer must fully describe the features of a document to except loss arising from them, and (2) a full description of any excepted “feature” ensures that “[t]he Insured will not be misled.” The Court interpreted this

language as distinguishing between the two methods of taking express exception to matters. (*Id.* at 317-318.) The first method lists both an excepted document and every matter within it as a separate exception, and the second method lists the excepted document in detail but only mentions in general the expressly excepted matters within the document.⁷ (*Id.* at 318.) Interpreting these methods in connection with the LandAmerica article, the Court found that in no way must a lender review all of the recorded documents for an opinion to ensure that it does not contain a provision that might harm them. (*Id.* at 318.)

Conclusion

It remains to be seen whether courts in the Ninth Circuit will follow in the footsteps of *Nationwide*. Regardless, insurers should be aware that when issuing an ALTA 9 Endorsement, a reference to the specific “covenant, condition, or right in question” in Schedule B may be necessary to ensure that it is “expressly excepted” from coverage found in paragraph 1(b)(2) of the endorsement.

⁷ For example, it does not disclose the party benefitting from each expressly excepted matter. (*Id.* at 318.)