

February 17, 2010

NOTICE REGARDING ELIMINATION OF CREDITORS' RIGHTS TITLE INSURANCE COVERAGE

As another example of the current challenges in the real estate industry, the major title insurance companies have announced that they are discontinuing their broad "creditors' rights" coverage for policies issued after February 8, 2010. Previously, title companies had offered a policy endorsement affirmatively insuring against **challenges to (i) vesting of title in the insured owner or (ii) the validity or enforceability of a mortgage lien, based on a claim that the transaction creating such title or lien involved a fraudulent conveyance or avoidable preference under federal or state law bankruptcy, solvency or other "creditors' rights" laws.** Buyers and lenders have often elected to rely on such coverage as a way to deal with certain creditors' rights and bankruptcy risks; for example:

1. **As a prospective purchaser of commercial property** – If the seller turns out to have been insolvent or near insolvency, there may be a risk that a transaction vesting title in the buyer will later be attacked as a fraudulent conveyance. And if the buyer is related in some fashion to the seller (i.e., an "insider"), there may be a heightened risk of the transaction being "avoided" because of the status of the buyer, particularly in a bankruptcy setting, as a "preferential transfer."
2. **As a prospective lender for commercial property** – While the focus is slightly different for a loan transaction, bankruptcy court decisions over the years have set aside or modified mortgages because of fraudulent transfer issues, and, in addition, bankruptcy courts may order mortgage payments to be disgorged as a preference depending on the value of the collateral (this risk is at a heightened level today because of current real estate market conditions). If the mortgage financing is for the acquisition of a property in a "short sale" or involves circumstances where the creditors of the seller in a purchase money mortgage financing transaction may not be paid in full or paid in part, the concerns may be heightened.

In both cases, a buyer/owner or lender will no longer be able to look to its title insurance coverage to pay the costs of defending the creditors' rights challenges described above or to pay damages if the challenge is successful (although under the ALTA 2006 form of title insurance policy insureds will still be covered for creditors' rights related defects arising in the "back chain of title" - i.e., as a result of fraudulent conveyances or preferential transfers in transactions that affected title prior to the transaction directly creating the interest of the current insured owner or lender).

In addition, title companies advise that they will continue to provide the previously available broad creditors' rights coverage for a transaction that was approved for the coverage prior to February 8, 2010, but where the transaction has not yet closed and/or the title policy has not yet been issued.

If you have any questions regarding this matter, the specifics of your particular transaction or the policy being followed by a particular title insurance company, please contact your Honigman attorney.

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