



# NJ N2K Hour: Understanding the Policy Series

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Exclusions from Coverage

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# What are Exclusions from Coverage?

- Exclusions are any matters that are specifically excluded from the coverage of the title policy.
- The Company will not pay loss or damage, costs, attorneys' fees, or expenses that arise by reason of any of the specific matters that are listed in the section entitled "Exclusions from Coverage" on the ALTA Owner's or Loan Policy of Title Insurance.
- There are a total of seven (7) exclusions listed on the 2021 ALTA Owner's policy, and a total of nine (9) exclusions listed on the 2021 ALTA Loan policy.
- The policy Exclusions limit the coverage of the policy, and they typically deal with issues that are outside the control of the title company, and for which the title company assumes no liability.
- Exclusions also apply to every policy and are not transaction specific, unlike exceptions which are typically added to policies on an individual basis.



# Exclusions from Coverage

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# Exclusion 1 – OP and LP

**1. a. any law, ordinance, permit, or governmental regulation (including those relating to building and zoning) that restricts, regulates, prohibits, or relates to:**

**i. the occupancy, use, or enjoyment of the Land;**

**ii. the character, dimensions, or location of any improvement on the Land;**

**iii. the subdivision of land; or**

**iv. environmental remediation or protection.**

**b. any governmental forfeiture, police, regulatory, or national security power.**

**c. the effect of a violation or enforcement of any matter excluded under Exclusion 1.a. or 1.b.**

# Exclusion 1 (cont.)

- Exclusion 1 of the policy does not cover the effect of any violations of said governmental laws or regulations.
- However, this exclusion shall not apply if a notice affecting the Land is recorded in the Public Records for a violation or intention to enforce the governmental law or regulation.
- Zoning coverage can be offered via the ALTA 3 series of endorsements.
- However, the ALTA zoning endorsement only provides affirmative coverage to an Insured as to the zoning classification of the Land and the subsequent uses allowed by the zoning ordinance for the Land as of the Date of Policy.
- As for subdivisions, state statutes enable cities and counties to pass ordinances governing the division of property into subdivisions, determining the divisions of property that are not to be considered subdivisions and setting forth the necessary requirements for the legal establishment of "plats of subdivisions."

# Exclusion 1 (cont.)

- The ALTA 26 Subdivision endorsement can also be issued on both an Owner's and Loan policy when the land to be insured is a lot described with reference to a recorded plat of a subdivision.
- However, it is necessary that a thorough examination of the plat be made in order to determine its effect on the land and to ascertain that all statutory requirements have been complied with.
- A prospective purchaser or lender may also apply in writing to the municipality to obtain a subdivision certificate certifying whether or not such subdivision has been approved by the Planning Board.
- Please note that the ALTA Zoning and Subdivision endorsements do not fully supersede Exclusion 1 on the ALTA Owner's and Loan policies.

# Eminent Domain Exclusion – 2 (OP & LP)

## 2. Any power of eminent domain. Exclusion 2 does not modify or limit the coverage provided under Covered Risk 7.

- Eminent domain is the power of the state or federal government to acquire property for public purposes, and it is derived from the Takings Clause of the Fifth Amendment of the U.S. Constitution.
- The U.S. Supreme Court has held that the federal government and each state has the power of eminent domain – the power to take private property for “public use” provided that just compensation be paid.
- The term “public use” is a highly controversial issue, and any takings that are not directly covered under the public use doctrine will likely violate due process rights under the 14th Amendment of the U.S. Constitution.
- Courts will determine if a taking is covered under the public use doctrine.

# Eminent Domain Exclusion (cont.)

- The power of eminent domain may be delegated by the states to counties, cities, villages, school boards, quasi-public corporations, and public utility corporations.
- The delegation by the state of the power of eminent domain is generally granted by statute.
- A condemnor is the government agency taking the property, whereas a condemnee is the property owner whose property is taken.
- The time of taking occurs when the award of compensation is deposited in the registry of the court unless a specific statute provides otherwise.
- The current statutory authority for condemnation proceedings in NJ is found in the Eminent Domain Act of 1971 (**N.J.S.A. 20:3-29**).



# Eminent Domain Exclusion (cont.)

- Although eminent domain is a covered risk under Covered Risk 7, the covered risk is limited only to the extent of the exercise described in an Enforcement Notice; or the taking occurred and is binding on a purchaser for value without Knowledge.
- If any recorded document is found or disclosed in a public records search relating to a condemnation proceeding, then an appropriate exception must always be included in the title commitment or policy.
- If a prior taking exists, the public records should disclose either:
  1. An Order of Taking granting possession to the government; or
  2. A Final Judgment condemning the property, based upon the filing of a petition for eminent domain in the circuit court records of the appropriate county.

# Exclusion 3 (OP & LP)

- 3. Any defect, lien, encumbrance, adverse claim, or other matter:**
  - a. created, suffered, assumed, or agreed to by the Insured Claimant;**
  - b. not Known to the Company, not recorded in the Public Records at the Date of Policy, but Known to the Insured Claimant and not disclosed in writing to the Company by the Insured Claimant prior to the date the Insured Claimant became an Insured under this policy;**
  - c. resulting in no loss or damage to the Insured Claimant;**
  - d. attaching or created subsequent to the Date of Policy (Exclusion 3.d. does not modify or limit the coverage provided under Covered Risk 9 or 10); or**
  - e. resulting in loss or damage that would not have been sustained if consideration sufficient to qualify the Insured named in Schedule A as a bona fide purchaser (or encumbrancer – LP) had been given for the Title (Insured Mortgage – LP) at the Date of Policy.**

# Created, Suffered, Assumed or Agreed to by the Insured

- If a defect, lien, encumbrance, or adverse matter is created or suffered by the insured, then it is excluded from coverage on the policy.
- One example is if the insured has a judgment lien filed against them. Even if the judgment lien was filed **PRIOR** to the named insured acquiring the property, the judgment lien against the insured is excluded from coverage based on Exclusion 3a.
- Another example is if the insured is named in a lawsuit or litigation matter which would impact their ability to refinance or sell their property. Even if the litigation matter was filed before the insured acquired the property, this matter would be excluded from coverage since it is an act of the insured.
- Lastly, Exclusion 3a would also apply in a scenario if the named insured granted an easement to a third party, since the encumbrance was created by the insured.

# Matters not Known to the Title Company

- Exclusion 3(b) would exclude defects known to the insured and not disclosed to the title company in writing.
- Basically, if the buyer on a transaction was notified by the seller and is now aware of an encumbrance or defect on the property which is not disclosed to the title company prior to the closing date, then the buyer would be excluded from coverage if they file a claim regarding the same encumbrance or defect after the policy is issued.
- If there is any defect or encumbrance which is not disclosed in the public records, but it is known by the buyer and seller prior to closing, then the buyer and seller must notify the title company in writing of the known defect, so the title company can either provide affirmative coverage or raise the encumbrance or defect as an exception on the policy.

# Case Law for Exclusion 3(b)

- In *Manchester Fund, Ltd. v. First Am. Title Ins. Co.*, the attorney of an insured purchaser learned before the issuance of the title policy that the United States had filed a notice of lis pendens on the property but that the lis pendens was improperly indexed. **332 N.J. Super. 336, 346 (Ch. Div. 1999)**.
- Since the purchaser did not inform the title company about the LP, the court held that because the insured was aware of an adverse claim that was not part of the public record and did not disclose that fact to the insurer, it triggered the express 3(b) exclusion and the insured was not entitled to coverage.
- The effect of Exclusion 3(b) is to impose on the insured a duty to disclose to the insurer any defects of which the former has knowledge.

# Case Law for Exclusion 3(b) (cont.)

- In 2015, the New Jersey Appellate Division affirmed a trial court's grant of summary judgment to a title insurer, holding that the title insurer had no duty to defend a lawsuit initiated against the insured that was based on an alleged agreement with the insured regarding title to the subject property. *Carrington v. Chicago Title Ins. Co.*, 2015 WL 6758365 **(N.J. Super. Ct. App. Div. Nov. 6, 2015)**.
- This case involved a purchaser who acquired the property in 1998.
- Chicago Title issued a title insurance policy to the purchaser at the time of purchase.
- In December 2011, the siblings of the insured sued the insured in chancery court claiming that they had a verbal agreement in place that they would all purchase the property in the insured's name due to their poor credit history.
- Title would then be put in everyone's names once the siblings' credit had improved.

# Case Law for Exclusion 3(b) (cont.)

- After the lawsuit was filed, the insured retained counsel, who wrote to Chicago Title and stated that he had filed an answer to the complaint but wanted Chicago Title to assign counsel to assume representation of the insured.
- By letter dated April 12, 2012, Chicago Title declined to provide legal representation for the insured's defense, citing the exclusions in the policy.
- The insured then sued the title company, alleging that the title company had unlawfully failed to provide a defense, had acted in bad faith, and had violated the Consumer Fraud Act.
- At the trial level, the court granted summary judgment for the title company, in which the insured appealed the decision.
- The Appellate Division affirmed the decision, holding the claims were "clearly excluded under the policy," primarily under Exclusion 3(b), and that the title company had no duty to defend.

# Post-Policy Events – Exclusion 3(d)

- Any defects, liens, encumbrances, adverse claims or other matters that attach or are created subsequent to the Date of Policy are expressly excluded from coverage.
- Since the title policy insures “as of the Date of Policy,” title defects are covered only if they existed before the date the policy was issued.
- Any title defects or issues that arise after that time are not included within the policy’s coverage.
- For many states, where mechanics liens are a concern, Exclusion 3(d) does not apply to any mechanic's lien insurance offered elsewhere in the policy.
- However, since NJ is a race-notice jurisdiction, mechanics lien coverage is not an issue in NJ if a Notice of Unpaid Balance (NUB) or Construction Lien Claim (CLC) has not been filed against the property prior to the policy date.



# Post-Policy Events (cont.)

- One example is if a purchaser acquires a property, and six months later their neighbor builds a fence which encroaches onto the insured's property.
- The encroachment would be considered a post-policy event and not covered under Exclusion 3(d), since the fence was built **AFTER** the insured acquired the property.
- For the Owner's policy, Covered Risks 9 and 10 are not affected by Exclusion 3(d). Covered Risk 9 concerns creditors' rights issues, and Covered Risk 10 is gap coverage for matters that occur post-policy but before the recording of the deed or conveyance instrument.
- For the Loan policy, Covered Risks 11, 13, and 14 are not affected by Exclusion 3(d).
- Covered Risk 14 in the Loan policy provides post-policy title insurance for the gap, if any, between the Date of Policy and the date the Insured Mortgage records in the Public Records.

# Notice of Settlement

- In NJ, a Notice of Settlement (NOS) must be recorded for **EVERY** transaction, as it provides constructive notice of a purchase or refinance and acts as a shield for the title company in relation to the gap coverage provided in Covered Risk 10 (OP) and Covered Risk 14(LP).
- Per N.J.S.A. 46:26A-11, a notice of settlement shall be effective for 60 days from the date of recording, unless it is terminated by the recording of a "discharge of notice of settlement."
- The effective period of a notice of settlement may be extended for one period of 60 days by recording an additional notice of settlement before the expiration or discharge of the notice of settlement.
- NJ is a race-notice jurisdiction, so once a Notice of Settlement is on record, it has priority over any subsequent lien or encumbrance which is filed against the property, provided the transaction closes and the Deed or Mortgage is recorded within 60 days of the NOS being recorded.

# Doing Business Exclusion – 4 (LP)

## **4. Unenforceability of the lien of the Insured Mortgage because of the inability or failure of an Insured to comply with applicable doing-business law.**

- In some states, the making of a mortgage by a foreign entity is considered to be "the doing of business" and state laws provide that such foreign entities must be licensed to do business in those states.
- The penalty for failure to qualify is that any contract made by such an unlicensed entity is void.
- In most states, such contracts are considered valid but unenforceable until the lender-entity is licensed.
- The Exclusion for Coverage number 4 of the ALTA loan policy protects the Company from liability arising because of the failure of the lender-entity to qualify in the state where the land is located.
- A Doing Business endorsement is also not available in NJ for lenders.

# Usury Exclusion – Exclusion 5 (LP)

**5. Invalidity or unenforceability of the lien of the Insured Mortgage that arises out of the transaction evidenced by the Insured Mortgage and is based upon usury law or Consumer Protection Law.**

- Under New Jersey law, the following are the civil and criminal usury limitations:
- Civil usury rates: Under N.J.S.A. 17:27 et. seq., interest rates generally cannot exceed 6% per year, or in some cases 16% per year if there is a written contract that specifies a particular interest rate.
- Criminal usury rates: Under N.J.S.A. 17:27-19, lenders can be subject to criminal penalties if they charge interest rates of more than 30% for non-corporate borrowers or more than 50% for corporate borrowers.
- Unlike some other states, NJ **does not** have a Usury endorsement, so usury coverage is not available in NJ for lenders.

# EXCLUSIONS - Creditors Rights

## Exclusion 4 (OP)

### Owner Policy

**4. Any claim, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors'**

**rights law, that the transaction vesting the Title as shown in Schedule A is a:**

**a. fraudulent conveyance or fraudulent transfer;**

**b. voidable transfer under the Uniform Voidable Transactions Act; or**

**c. preferential transfer:**

**i. to the extent the instrument of transfer vesting the Title as shown in Schedule A is not a transfer made as a contemporaneous exchange for new value; or**

**ii. for any other reason not stated in Covered Risk 9.b.**

# **EXCLUSIONS - Creditors Rights**

## **Exclusion 6 (LP)**

### **Loan Policy:**

**6. Any claim, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors'**

**rights law, that the transaction creating the lien of the Insured Mortgage is a:**

**a. fraudulent conveyance or fraudulent transfer;**

**b. voidable transfer under the Uniform Voidable Transactions Act; or**

**c. preferential transfer:**

**i. to the extent the Insured Mortgage is not a transfer made as a contemporaneous exchange for new value; or**

**ii. for any other reason not stated in Covered Risk 13.b.**

# Understanding the Creditors Rights Exclusion

- A fraudulent conveyance or voidable transfer is the conveyance of title to real property for the express purpose of putting it beyond the reach of a known creditor.
- This occurs when a debtor seeks to take advantage of their creditor by structuring a transaction with the intent to hinder, delay, or defraud their creditor.
- A preferential transfer is a payment that a debtor makes to one or more creditors before filing for bankruptcy which results in paying back an unequal amount of debt to their other creditors.
- The policy expressly excludes any claims arising from bankruptcy actions that characterize the current insured transaction as a fraudulent, voidable, or preferential transfer.
- However, this exclusion does not negate the coverage provided in Covered Risk No. 9 (OP) and Covered Risk No. 13 (LP) for any creditors' rights matters that occurred prior to the current insured transaction.

# PACA/PSA Exclusion - 5(OP) & 7(LP)

## Owner Policy:

**5. Any claim of a PACA-PSA Trust. Exclusion 5 does not modify or limit the coverage provided under Covered Risk 8.**

## Loan Policy:

**7. Any claim of a PACA-PSA Trust. Exclusion 7 does not modify or limit the coverage provided under Covered Risk 8.**

- PACA/PSA is a new exclusion on the 2021 ALTA policies.
- On the 2006 ALTA policies, PACA/PSA claims had to be listed as a general exception on the policy.
- The PACA/PSA exclusion on the 2021 ALTA policies eliminates the need for an exception on Schedule B.



# What is PACA/PSA?

- PACA-PSA Trust is now a defined term in the Conditions of the 2021 ALTA policies and is defined as a trust under the federal Perishable Agricultural Commodities Act or the federal Packers and Stockyards Act or a similar State or federal law.
- PACA was passed by Congress in 1930 to protect agricultural produce suppliers from unscrupulous vendors who refused to pay the suppliers for their goods.
- These federal statutes can pose a title risk as they create a trust for the benefit of unpaid sellers and suppliers of perishable agricultural commodities and poultry, poultry products, livestock, dairy, and meat products.
- Property acquired or commingled with trust funds may subject that property to the PACA/PSA trust.

# Exclusion 6 (OP) & 8 (LP)

**6. Any lien on the Title for real estate taxes or assessments imposed by a governmental authority and created or attaching between the Date of Policy and the date of recording of the Insured Mortgage in the Public Records. Exclusion 8 does not modify or limit the coverage provided under Covered Risk 2.b. or 11.b.**

- Any real estate taxes or assessments which are due and payable, but unpaid as of the Date of Policy are insured through Covered Risk 2b.
- However, any real estate taxes or assessments which are imposed by the municipality post-policy are excluded from coverage.
- For example, in NJ, if 2<sup>nd</sup> quarter taxes for 2024 are due and payable as of the date of closing, then 2<sup>nd</sup> quarter taxes would be covered under the policy. However, 3<sup>rd</sup> quarter taxes for 2024 are excluded from coverage since they are not yet due and payable until August.

# Exclusion 6 (OP) & 8 (LP) (cont.)

- However, please note that Exclusion 8 in the loan policy does not affect the coverage provided under Covered Risk 11(b), which states that the title policy shall give coverage for the lack of priority of an Insured Mortgage over street improvement assessment liens for ongoing or completed construction at the Date of Policy.
- Affirmative coverage for street assessment liens is also available via the ALTA 1 endorsement (NJR 5-86).
- Street assessment liens are typically verified through a municipal tax search; examination of the public records for any evidence of street improvements; and confirmation from the tax assessor that there have been no assessments for the particular property.

# EXCLUSION - Discrepancy in Land 7 (OP) and 9 (LP)

**7. Any discrepancy in the quantity of the area, square footage, or acreage of the Land or of any improvement to the Land.**

- The discrepancy in land exclusion is a new exclusion on the 2021 ALTA policies.
- On the 2006 ALTA policies, any discrepancy in land related to acreage or square footage had to be listed as an exception on Schedule B.
- The new exclusion on the 2021 ALTA policies eliminates the need for adding an exception to Schedule B on both the Owner's and Loan policies.

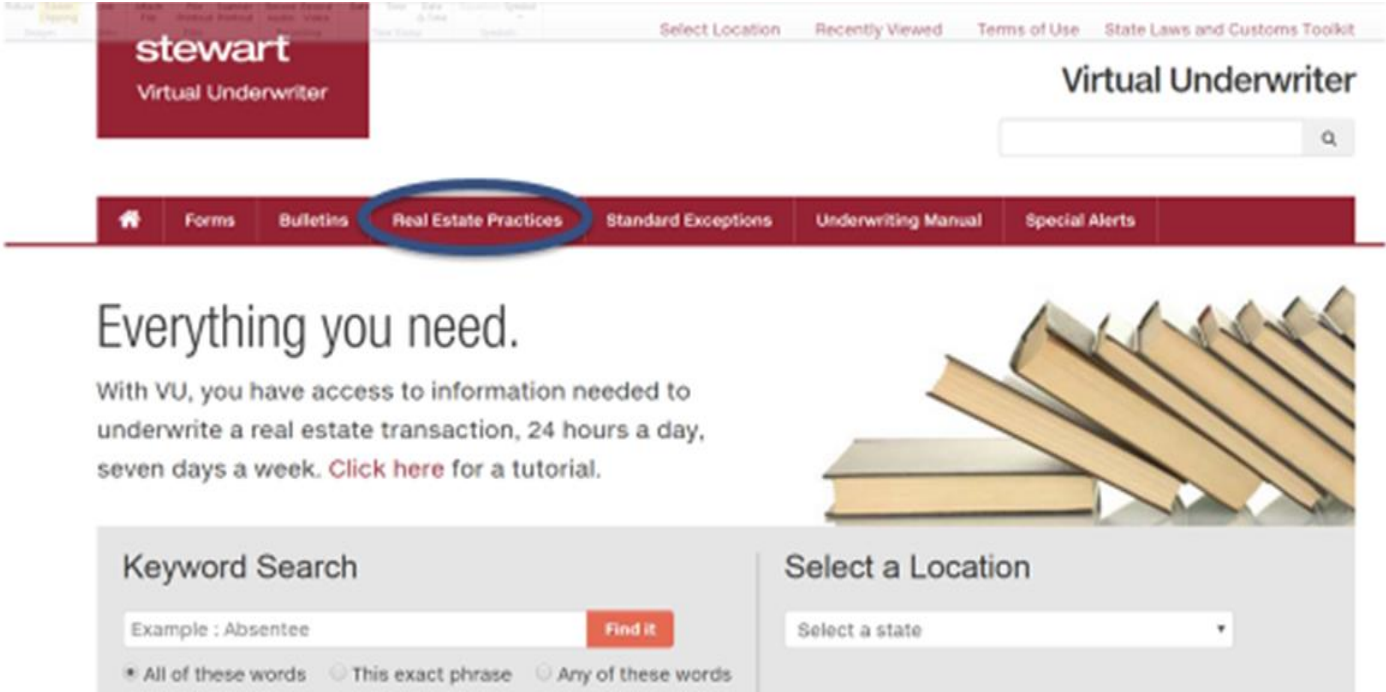
# Discrepancy in Land Exclusion (cont.)

- Title companies do not insure that the stated acreage or square footage on a legal description is accurate.
- This was typically accomplished in the past by deleting any reference to acreage, adding “more or less” as qualifying language, or adding an exception to accuracy of the stated acreage.
- If a plat or survey was insured which stated the acreage, then any reference to acreage in the plat or survey had to be deleted.
- Since an exception had to be added on previous ALTA policy forms, this new exclusion was specifically added to the 2021 ALTA forms.

# Conclusion and Wrap-Up

- The PACA/PSA exclusion and Discrepancy in Land exclusion are new exclusions on both the 2021 ALTA Owner's and Loan policies.
- Exclusion 3(a) and 3(b) on both the Owner's and Loan policies protects the title company from any matters that are created, assumed, or agreed to by the insured, and any matters that are not known by the title company.
- There is a considerable amount of case law, especially in NJ, when it comes to Exclusion 3(a) and 3(b) and how it is applied.
- Any title defects or issues which are not expressly excluded from the policy must be raised as exceptions on the policy if they become known by the title company prior to the closing date.

# www.VUwriter.com



The screenshot shows the Stewart Virtual Underwriter website. At the top left is the Stewart logo with the text "Virtual Underwriter". To the right are navigation links: "Select Location", "Recently Viewed", "Terms of Use", and "State Laws and Customs Toolkit". Below this is a search bar with a magnifying glass icon. A dark red navigation bar contains several menu items: a home icon, "Forms", "Bulletins", "Real Estate Practices" (circled in blue), "Standard Exceptions", "Underwriting Manual", and "Special Alerts". The main content area features the heading "Everything you need." followed by the text: "With VU, you have access to information needed to underwrite a real estate transaction, 24 hours a day, seven days a week. [Click here](#) for a tutorial." To the right of this text is an image of several books stacked together. Below the text and image are two search sections. The "Keyword Search" section has a text input field containing "Example : Absentee", a red "Find it" button, and three radio button options: "All of these words" (selected), "This exact phrase", and "Any of these words". The "Select a Location" section has a dropdown menu with the text "Select a state" and a downward arrow.

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Please mark your calendars for our:

**April N2K HOUR**

**Understanding the Policy Series - Conditions**

Tuesday

April 9th

11:00AM