

March 24, 2010

Dear « »:

A recent California case may significantly affect title insurance coverage when real property is transferred between different forms of title even when the beneficial owners remain unchanged. The issue in the case was whether the members of a LLC succeeded to title insurance coverage on LLC real property after the company was dissolved and the real property was distributed out to the members.

Patrick and Maria Kwok purchased real property through an LLC that they owned. Transnation Title Insurance issued a title policy that named the LLC as insured. The property then became undevelopable due to an easement dispute, and the Kwoks filed a claim under the title policy. Unfortunately, at the same time the dispute was brewing, the Kwoks voted to dissolve the LLC and to distribute out the real property to themselves as individuals. The deed, however, conveyed the real property not to the Kwoks individually but to themselves as trustees of their revocable living trust.

The Transnation policy covered the LLC and “those who succeed to the interest of the named insured by operation of law.” The court of appeal held that the distribution to the members of the LLC upon dissolution was by operation of law and coverage would have continued. The Kwoks however, went the extra step of transferring the property to themselves as trustees of their revocable trust. The court ruled that the transfer to the trust was not by “operation of law” but a voluntary transfer and therefore allowed the title insurer to deny coverage.

I suggest that the transferors consider the following steps in the future before conveying real property to another form of ownership.

- Review any existing title policy before coverage issues arise to determine the named insured and any coverage of successors in interest.
- Review the current members or partners of the entity insured to identify correctly the successors in interest.
- Request an endorsement from the title insurer for any change in the identity of the successor in interest.

The court's decision noted twice that the Kwoks did not obtain an endorsement from the title insurer adding their revocable trust as a named insured.

When seeking coverage under an insurance policy, each step matters. The Kwoks argued unsuccessfully that their revocable trust was an "alter ego", and that the beneficial ownership of the LLC real property was unchanged. The court rejected that argument because under the policy terms only successors whose interest arose by "operation of law" were insured.

This recent case is a cautionary tale that emphasizes the importance of naming the correct entity as the insured on a policy of title insurance, or any other insurance policy. The same ruling would presumably apply if the owners transferred real property to a limited partnership or LLC and failed to obtain an endorsement from the insurer naming the correct entity as the insured. If you have any questions regarding insurance coverage for partnership or company real property, I would be pleased to discuss these issues with you in greater detail.

Kind regards.

Very truly yours,

JOHN A. HARTOG, INC.