

Alerts and Updates

TITLE INSURANCE COMPANIES ELIMINATE CREDITORS' RIGHTS COVERAGE FOR REAL ESTATE BUYERS AND LENDERS

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Recently, various national title insurance companies, such as First American Title Insurance Company and the entire Fidelity National Title Group—which includes Chicago Title Insurance Company, Fidelity National Title, Ticor Title, Lawyers Title, Commonwealth Land Title, Security Union Title and Alamo Title—officially announced that, effective immediately, creditors' rights coverage will no longer be available by endorsement, affirmative coverage, issuance of the American Land Title Association (ALTA) 1970 policies or otherwise. This change affects both owner's and loan policies.

Creditors' rights coverage previously provided the purchaser of real property or its lender with insurance that the transaction at issue would not be unwound or set aside by a creditor of the seller or borrower, as applicable, on the basis of the transaction constituting a voidable preference or fraudulent conveyance under federal bankruptcy, state insolvency or similar creditors' rights laws. This coverage also included attorneys' fees and defense costs resulting from such claims. The costs in these cases can be substantial.

The elimination of title insurance, and the resulting significant costs from a claim by a creditor, underscores that buyers and lenders may want to conduct a greater level of due diligence regarding the parties to the transaction and the terms of each transaction to identify whether any of the elements of a potential claim by a creditor exists. In general, a successful creditors' claim requires proof that the transaction was either: (i) made with the intent to hinder, delay or defraud a creditor or (ii) for less than "reasonably equivalent value" when the transferor was insolvent at the time of the transfer or became insolvent as a result of it. If a successful preference or fraudulent transfer claim is asserted by a creditor, a court may set aside the subject transaction. The analysis would be fact-specific and may turn on the circumstances of a particular transaction. However, for any transaction, a buyer or lender may want to examine all available data and information to identify if any of the foregoing factors are present.

As part of such examination, buyers or lenders should thoroughly investigate the financial condition of the seller or borrower, as applicable, at the time of entering into the particular transaction and analyze the likely impact of the transaction on such party and its creditors going forward. They may also want to obtain and review detailed financial statements, credit ratings

and similar reports, if available. When dealing with a public company, buyers or lenders may also want to review the company's public filings and stock prices, as the company's recent stock prices can indicate the market's perception of its financial condition. The use of solvency opinions in real estate transactions may increase, although this has yet to be seen. Buyers and lenders should continue to perform full lien and judgment searches on the parties to the transaction and affiliated entities, with particular attention given to any identified creditors, even if these creditors have no direct liens encumbering the asset in question. They also may want to consider requesting additional representations from a seller or borrower concerning its financial condition, identifying its significant creditors and confirming that the transfer will not result in insolvency. Although these representations may be of limited value if the party turns out to be insolvent, heavily qualified representations or a refusal to provide such representations may signal potential issues with the transaction. If any of these investigations identify issues or concerns that the seller or borrower may be insolvent or become insolvent, the transaction may be at risk.

Sellers and borrowers, particularly privately held companies, may not wish to provide details on their financial condition or make additional representations in the transaction documents. Specifically negotiated confidentiality provisions may provide adequate comfort to allow for the sharing of financial or other sensitive data, but a refusal to share any of the necessary information by a seller or borrower may indicate deeper issues.

Another factor to consider when determining the rights of third-party creditors is the purchase price and whether it represents "reasonably equivalent value." Property values have been experiencing a continuing decline over the last few years, which has made agreement on current market value increasingly complex. Even when a buyer and seller agree on the price, the transaction may still face challenges from third-party creditors. If challenged on the grounds that "reasonably equivalent value" was not received, a court is likely to look at all factors affecting the price determination. An independent and reputable third-party appraisal may be helpful, but the appraiser should be completely independent and disinterested in the outcome of the transaction. The methodology used by the appraiser will be evaluated and should be an accepted method for the particular asset type in question. If the sale was subject to a bidding process, that information may be important to note, as it may signify the actual market price for such an asset, assuming the highest price was accepted.

In light of the current economic climate and the issues facing commercial real estate, this change by the title insurance industry is likely to significantly shift the risk of a claim by a creditor to the buyers and lenders. Investors intending to purchase so-called "distressed assets" at very low prices may want to be cautious in assessing and understanding these risks prior to moving forward with a transaction. Buyers and lenders may want to consult with experienced professionals to

fully investigate each transaction as thoroughly as possible to identify potential creditors and claims that may be made based on the particular facts and circumstances. While it may be impossible to identify and eliminate all potential claims, with appropriate due diligence, risks can be mitigated—and significant future costs and expenses dealing with claims of third-party creditors may be averted.

For Further Information

If you have any questions about this *Alert*, please contact [Darrin S. Forbes](#), [Douglas J. Lubelchek](#), any other [member](#) of the [Real Estate Practice Group](#) or the attorney in the firm with whom you are regularly in contact.