

IN PRACTICE

TRUSTS AND ESTATES

Estate Planning Can Be Fatal To the Health of Your Title Insurance Coverage

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“Estate planning” generally involves the transfer of assets for lawful and beneficial purposes. When it involves the transfer of real property, it may also bring about unintended consequences — especially in the area of title insurance. Such was the recent finding by the Supreme Court, in *Shotmeyer v. New Jersey Realty Title Insurance Company*, A.2d - 2008 WL 2355781.

In 1981, two brothers purchased a large tract of land (168-plus acres) as an “investment.” The brothers jointly paid the purchase price and the deed by which they took title, named each as a “general partner” of a general partnership. An owner’s policy of title insurance was also purchased. The “insured” named in the title insurance policy mirrored the “grantee” named on the deed. The title insurance policy the brothers purchased contained a preprinted standard “anti-lapse” provision. It is this policy provision that defines “who” is entitled to the insurance coverage, and

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for “how long” such coverage will last.

For 10 years (from 1981 to 1991), all went well. However, in 1991, the brothers sought and obtained professional legal advice concerning their “estate plans.” The advice the brothers received was that they should convey their general partnership ownership interest in their investment land, by a grant deed, to a newly created New Jersey limited partnership — thereby ostensibly obtaining an “estate” benefit while in no way relinquishing their complete control and enjoyment of the land.

So, in reliance upon such advice, the brothers did grant a deed that year (1991), from their general partnership to a newly created limited partnership. The deed was one of “Bargain and Sale” (i.e., a quit claim deed with covenants against grantor’s acts) and states a “\$10.00” consideration. No “Affidavit of Title” was executed. No further covenants of title were made. In all other aspects, the land remained controlled by the two brothers, just as it had been used before their deed of conveyance. From that point on, the record title ownership of the land was changed and that seemingly simple alternation was recited as being intended to merely accomplish

the professionally advised “estate planning.” But for the mere name change in the record title — everything else remained the same as before. Yet, this seemingly innocent conveyance of title, when viewed under the microscope of the title insurer, also automatically triggered the anti-lapse coverage provision clearly recited in the title insurance policy.

It took yet another 10 years for an insurance claim to surface. It was not until 2002, when the brothers made a title insurance claim concerning a cloud upon the title to a 12-acre portion of their original 168-acre tract. After settlement attempts failed, a dispute erupted as to the entitlement of policy coverage to the “new” limited partnership when the “old” general partnership was named as “the insured.” As a result of that dispute, both the “old” and the “new” partnerships made a joint title insurance claim. When the title insurer resisted and then refused, the “claim” litigation ensued.

In its defense, the title insurer raised various policy-related defenses, including the anti-lapse provision — arguing that once the 1991 deed was recorded, the title record for the land clearly shows that “[t]he ‘insured’ no longer holds title to the land described in the subject policy of title insurance.”

The insurer argued that the “insurable interest” held by the named insured in the title insurance policy ceased to exist as of the 1991 deed. The named insured technically no longer owned title to the land. The named insured reserved no estate or title interest to the

land. There was simply no title interest remaining in the named “insured” — for purposes of applying coverage.

In the ensuing lawsuit, a summary judgment of dismissal was granted to the title company by Law Division Judge Joseph J. Riva in the lower court. His decision relied upon the policy’s anti-lapse provision and its limitation as to the definition of “insured.”

On the appeal, the Appellate Division criticized the result achieved by the title company below. The Appellate Division rejected the Law Division Judge’s analysis, and ruled that notwithstanding the 1991 deed — the title insurance was preserved based upon four liberal notions: “beneficial interest”; “alter ego”; “reasonable expectation”; and *contra proferentem* — it is the title insurer who must suffer a strict construction of the policy and all of its terms.

By its decision, the Appellate Division reversed the Law Division Judge, and remanded the case back for further proceedings.

In response to the Appellate Division reversal, the title company appealed. The petition to the Supreme Court was granted. The matter was argued before the Court on November 28, 2007.

In writing for a unanimous Court, Chief Justice Rabner addressed the issue of whether individual partners and/or their partnership entities are entitled to claim interchangeable title insurance coverage — notwithstanding the title policy’s prohibition — and, notwithstanding that the conveyance of title was singularly motivated by professional advice and solely intended to achieve “estate planning” benefits.

In its opinion the Supreme Court said that whatever the intention of the conveyance, the title insurance coverage cannot be continued in contravention of the express policy language, for to do so would effectively create a new insurance agreement for the parties. The Supreme Court agreed with the Law Division’s judge, finding that policy coverage lapsed in 1991, when the general partnership conveyed away its entire interest in

the property by a voluntary conveyance, expressly contemplated by the title insurance policy.

As support for its decision, the High Court cited established partnership law that distinguishes title held by a “partnership” from fee ownership otherwise enjoyed by the “partners.” A general partnership and a limited partnership are each in “the eyes of the law” — separate and independent legal entities. Real property even when acquired by one or more partners in their capacity as partners, where the name of the partnership is stated in the deed, as a matter of law is “partnership property.” N.J.S.A. 42:1A-12(b) (2). Real property so acquired by a partnership remains the property of the partnership, and is not the property of the individual partners. N.J.S.A. 42:1A-11.

Applying this established partnership law, it is clear that when title to the real property changes from one held by a general partnership to one held by a limited partnership, neither the general partnership nor any of its partners have standing to sue the title insurer — neither as general partners, nor in their own names, nor on behalf of the grantee limited partnership. Conversely, once the title to real property was conveyed, neither the general partners nor the general partnership could any longer be held liable for any wrongful conduct by the grantee limited partnership. While it may be true that the same two brothers continued to enjoy an interest in the limited partnership — they held no title interest in the real property. Title to the real property was always in the legal entities — first the general partnership and then the limited partnership. By law, the individual partners owned no fee interest in the land. To hold otherwise would be to disregard the nature and legal viability of a limited partnership.

The Appellate Division’s suggestion that no real conveyance occurred from the general partnership to the limited partnership, was simply a false conclusion. As Trial Judge Riva correctly opined in his Law Division decision — the limited partnership shielded the indi-

vidual partners from liability and provided all of the benefits conferred to a New Jersey limited partnership — including estate planning benefits. By their acquisition of title in 1981, and again by their title conveyance of that title in 1991, the brothers intentionally created a “liability shield” that insulated them from any responsibility for a “cloud” on title to the subject property. In the event of future litigation concerning the title, only the partnership entity would be required to defend. Only the partnership entity and not its partners could be held personally liable for any adverse consequences as the result of such litigation.

Because the limited partnership is a legally existing separate entity, the “cloud” on title arising in 2002 was the “problem” of the limited partnership, and does not concern the insured. If a loss has been suffered because of the cloud on title — it has been suffered only by the limited partnership, who is not an “insured” under the policy, either before or after the conveyance.

The title insurance lapsed because the insured chose to “deed” away its title in a manner contemplated but prohibited by the insurance. The conveyance effectively provided total insulation to the “insured” from liability — which in turn sounded the death knell for the title insurance coverage.

While the individual partners may be legally entitled to avail themselves of the estate planning benefits emanating from their conveyance to a limited partnership — they can not do so in violation of the express prohibition found in the insurance contract. Since their conveyance of the title can only be viewed as a voluntary transfer, not as a conveyance by “operation of law,” it was error for the Appellate Division to create new legal rights. The title insurance simply lapsed, and Judge Riva’s trial court dismissal of the case was affirmed.

Estate planning can indeed be fatal to the health of your title insurance. ■