

It's good policy to check the facts surrounding disclosure

Defective title indemnities can create problems when it comes to selling at auction. *Wayne Smith* and *Shaun McGivern* offer some suggestions

If a property has a defective title, the owner will normally take out indemnity insurance. Such policies are designed to protect the insured from loss and expense in the event of a claim arising from the defects. They typically contain conditions relating to the disclosure of the policy to potential purchasers. The insured party must carefully abide by these so as not to invalidate the policy. However, when the owner intends to sell the property, it must not only adhere to the conditions but must also ensure that full disclosure is made to the purchaser.

For example, in some cases the title deeds to a property may have been lost. This might create uncertainty as to what restrictive covenants affect the property or whether these remain valid. The owner should therefore obtain defective title indemnity insurance in respect of the covenants.

Problems with auctions

A typical condition relating to the disclosure of such a policy would read as follows:

The existence of this indemnity or any information relating thereto shall not be disclosed to any third party other than bona fide purchasers, their mortgagees and lessees and their respective professional advisers without the prior written consent of the underwriters.

This clause is often overlooked, but if the conditions regarding disclosure are not observed, the policy will be void.

This clause should not cause problems where the purchaser, its mortgagees and lessees and respective professional advisers are identifiable as such, because it allows for the policy to be disclosed to such parties. The difficulty arises where the owner chooses to sell the property at auction. Such a sale is common where the property is subject to a number of problems; in fact, these are usually the types of problems that would prompt an owner to take out title indemnity insurance.

The difficulty with an auction sale is that the seller cannot establish, with certainty, whether or not a request for a property pack comes from a bona fide purchaser. The request could come from someone who is seeking to take advantage of the fact that the title is defective. The policy condition does state that the prior written consent of the underwriter could be obtained to enable the disclosure of the policy. However, in practice, the underwriter will not consent to disclosure if the property is being sold at auction. This is because the underwriter will be

● **Defective title indemnity insurance policies often forbid the disclosure of the policy, other than to a bona fide purchaser, its mortgagee and lessees and their respective professional advisers, without the consent of the underwriter**

● **Auctions present problems with disclosure since the owner cannot establish who is a bona fide purchaser**

● **CPSE replies to enquiry 5 cause problems since the owner is asked whether anyone has obtained or been refused insurance in respect of any defect in title yet the policy prevents disclosure**

● **A special auction condition should be drawn up**

unsure as to the identity of those to whom the policy might be disclosed and what claims could arise from such a disclosure.

While the owner may be aware that the policy should not be disclosed in its property pack, it will still be faced with a further potential pitfall. Enquiry 5.1 of the commercial property standard enquiries 1 (CPSE 1) specifically asks whether anyone has obtained, or been refused, insurance cover in respect of any defect in title of the property, including any restrictive covenant or a lost title deed.

Enquiry 5.2 of CPSE 1 goes further. It requests that, if insurance cover has been obtained, copies of all policy documents, including the proposal form, should be supplied and confirmation should be given that all conditions to such policies have been complied with. This creates a dilemma for the owner, in that although insurance has been obtained, the policy prevents the owner from disclosing it without the consent of the underwriter, which is unlikely to be forthcoming if the property is to be sold at auction.

Solving the dilemma

In looking for a solution to this dilemma, we have considered a number of potential responses that the seller could give in reply to enquiry 5 of CPSE 1.

First, the seller could state that it is unable to provide an answer to the enquiry. However, this reply would not necessarily be accurate because the seller clearly has the knowledge that would enable it to answer the question but, because of the condition in the policy, is prevented from doing so.

Alternatively, the seller could reply that there is no insurance policy of which the purchaser would have the benefit. This answer would not state that no such policy exists – because that would be untrue – but would merely observe that there was a policy in place the purchaser would not have the benefit of it, thereby implying that the purchaser would have to obtain its own insurance cover.

The problem with this proposal is that should a bidder be successful, it would be entitled to the benefit of the policy. Thus, again, this answer would not be entirely accurate. To leave the reply blank would probably serve only to prompt enquiries from potential purchasers.

The best approach, therefore, would be to include a special auction condition that states that if (which is not warranted) there is an insurance policy, it will be disclosed to the buyer after the date of the auction. The reply to enquiry 5 of CPSE 1 should then read “see conditions of sale”. This would avoid the problem of disclosure while minimising the risk of enquiry from the recipient of an auction pack.

Appropriate solution

Once the auction has taken place and a bona fide purchaser has been ascertained, the policy's existence could then be disclosed to that purchaser without breaching the conditions of the policy.

In conclusion, we would suggest that when preparing a property pack for auction, a copy of the title indemnity policy should be obtained and carefully read in order to identify the circumstances concerning disclosure. If these are unclear, it is important to obtain written instructions from the underwriter to determine whether it agrees to the disclosure of the policy.

We would also suggest that, when advising clients on their responses to enquiries 5.1 and 5.2, extreme care is taken because disclosure of the policy could constitute a breach of the policy, while non-disclosure could amount to misrepresentation.

For this reason, we believe that the most appropriate way to deal with this issue is by way of a special auction condition.

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