



Transfer of Title from Owner to a Related Entity Terminates Title Insurance Coverage

By Arnold D. Litt and Susan M. Marra

On June 5, 2008, in the case of *Shotmeyer, et al v. New Jersey Realty Title Insurance Company*, the Supreme Court of New Jersey reversed the Appellate Division (Supreme Court, A-125 Sept. Term 2006, decided June 5, 2008) agreeing with the trial court, that title insurance coverage provided by a policy terminated upon the transfer of title, notwithstanding the fact that the new entity had the same composition of membership as its predecessor.

The facts of the case are simply stated as follows:

Through a general partnership controlled by them, Shotmeyer, et al purchased a tract of land (the "property") in 1981 which was transferred to a new entity, a limited partnership also controlled by Shotmeyer, as part of an estate-planning program in 1991 and 1992. In 2001, Shotmeyer discovered the property was smaller than believed and filed a claim with the title company that insured the 1981 purchase. The title company declined coverage on the basis that the real party in interest, the insured, had transferred title, and therefore there were no further obligations on the part of the title company to provide coverage. The trial court agreed with the title company, but upon appeal, the Appellate Division reversed. The Appellate Division found that the Shotmeyers had never transferred their "beneficial interest" in the land and that both the general and limited partnerships were merely

alter egos of the Shotmeyers. The Supreme Court noted that the limited partnership entity shielded the individual partners from personal liability as contrasted with the general partnership in which the general partners were personally liable. The Court also found significant the fact that the general partnership entity remained with respect to its business operations. It only conveyed the real estate in question to the limited partnership. The Court found "that this

fact carries weight in analyzing whether the policy continues to offer coverage".

Unfortunately for the Shotmeyers, what started out as an estate planning tool, the conveyance to a limited partnership, resulted in the release of the title insurance company from any obligation to insure title relative to the successor entity. Its claim against the title company, therefore, was denied.

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News from Herten Burstein

- **Michael I. Lubin** has been appointed by the Supreme Court of New Jersey as Chairman of the District IIB Ethics Committee for Bergen County. Steven B. Harz has also been appointed by the Court as a member of the Committee for a four year term.
- **Andrew T. Fede**, as the Borough Attorney for Norwood, obtained a Superior Court, Law Division decision and order in June finding that Norwood and its Clerk did not violate New Jersey's Open Public Records Act, N.J.S.A. 47:1A-1 *et seq.* ("OPRA"), when they did not produce a copy of a document requested by the plaintiffs because that document was not in Nor-

wood's files. Applying the "rule of reason," the judge held that OPRA requests are not a "gotcha-game" played by document requestors and custodians. The judge also found for the plaintiffs on the OPRA claims that they asserted against another municipality, which we do not represent, after the plaintiffs settled with eight other municipalities that they also sued.

Mr. Fede also obtained a Superior Court, Law Division decision and order in July, on a summary judgment motion, finding that an individual and his newly-formed corporation were li-

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Landowner Gets Settlement for “Taking”

When the government takes aim at private property to be taken for some public purpose, more often than not any resulting litigation is a contest over how much the property owner should be paid, rather than whether the exercise of the power of eminent domain was appropriate in the first place.

From the landowner’s standpoint, it is important to realize that adequate compensation is not determined simply on the basis of the current use of the property. Instead, the landowner is entitled to the value of the property based on its “highest and best” use (whether that use already exists or is only in the eye of a developer), so long as such a potential use is not too speculative or otherwise foreclosed by applicable laws and regulations.

The importance to a property owner of negotiating compensation on the basis of a best-case, but realistic, development scenario for the property is illustrated by a recent case in which the owner of a vacant, 22,000-square-foot lot settled with a town for compensation in an amount that was about 27 times higher than the amount initially offered by the town.

The lot was zoned for residential use, although at the time of the condemnation action the owner had no building or development plans. Appraisers hired by the town offered an opinion that the vacant lot’s best use was only as open space, or as a buffer for an abutting lot. They reasoned that compliance with the town’s lot area and frontage requirements, as well as with its road standards for improving the dirt road on which the lot was located, would be so burdensome as to make any development of the property prohibitively expensive. They also indicated that extensive development costs would preclude development even if the lot was considered to have grandfathered status that would protect it from certain town requirements.

For its part, the landowner retained experts who opined that the lot was, in fact, suitable for residential purposes

and should be valued as such when arriving at a compensation figure for the taking. As the town’s experts had noted, there were various requirements on the books that, in theory, could be costly to comply with. However, an examination of past rulings by the town’s zoning and conservation officials showed that the lot was likely to be exempted from some of the requirements. Moreover, improvement of the dirt road, which would have been an

especially big-ticket item, was not likely to be required.

Both sides were necessarily looking into the future to some extent, but the landowner was able to depict a scenario for the lot that was optimistic enough to bring about a favorable monetary settlement with the town.

For more information on this case or any other land use planning matter, please contact Daniel Y. Gielchinsky or Nilufer O. DeScherer.

Cyber Insurance for Businesses

Businesses have been dependent on computerized information for some time now, but it has been only relatively recently that insurance companies have devised and offered insurance policies specifically tailored to the potential losses from a variety of problems that can affect a computer system.

An early impetus for cyber insurance was anticipation in the late 1990s of losses associated with the coming of “Y2K.” That concern turned out to be overblown, but the threats that have spurred cyber insurance offerings since then are real enough, including viruses, hackers, and legal injuries to others from information on a company’s website. One study has found that the average annual technology-related financial loss for United States companies more than doubled just from 2006 to 2007.

Another development that prompted more cyber insurance policies was the realization, which sometimes came as a surprise to insured businesses, that general liability policies did not cover computer problems. Cyber insurance is a good idea for all of the usual reasons associated with insuring against business losses. But it also makes sense because of the particular costs associated with respond-

ing to a computer data breach, especially now that many states have adopted data breach notification laws.

This kind of postmortem after a breach could include such measures as notifying affected customers, paying for credit monitoring for those customers, replacing compromised credit or debit cards, and undertaking forensic analyses of affected databases. All in all, there are some expensive scenarios to insure against.

Categories of Losses

The losses covered by cyber insurance generally fall into two categories: first-party losses, meaning those affecting the business itself; and third-party losses, meaning incidents mainly affecting outside parties, including the customers of a business. Of course, the same underlying problem can cause both kinds of losses, such as when unauthorized access to a computer system shuts down the computer system of a company whose customers or clients rely on that system through an extranet.

A comprehensive cyber insurance policy should encompass both kinds of risks. These are the typical categories of coverage:

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able for a Consumer Fraud Act judgment that Mr. Fede previously obtained against another corporation owned by the individual. The judge pierced the corporate veil, and found that the individual used these corporations as his alter ego to deprive the plaintiff of his right to collect on his judgment.

- **Andrew J. Cevasco** was recently appointed by the New Jersey Supreme Court to a three year term on its Committee on Character. The Committee reviews all applications for membership to the New Jersey Bar to determine the applicant's fitness to be admitted as an attorney at law in the State of New Jersey. He also continues to serve as a Member of the Board of Trustees of the Bergen County Bar Association.

Mr. Cevasco will be lecturing on Guardianships and Conservatorships at an NBI seminar in November, 2008.

- **Gianfranco A. Pietrafesa**, a member of the firm's business law practice group, was elected as the Secretary of the Business Law Section of the New Jersey State Bar Association. He has served on the Board of Directors of the Business Law Section since 2002.

In November, **Franco** will be serving as the moderator for the seminar "Legal Ethics for Transactional Lawyers," which is sponsored by the New Jersey Institute for Continuing Legal Education and the New Jersey State Bar Association Business Law Section. Franco developed the seminar several years ago and has organized and moderated it every year since then.

In addition to being a transactional lawyer, Franco is an experienced trial attorney and has written a chapter on drafting complaints in federal lawsuits. The chapter was included in the

second edition of *New Jersey Federal Civil Procedure*, published by New Jersey Law Journal Books in September.

Finally, **Franco** continues to be active in his community and was recently appointed to the Board of Trustees of the Louis Bay 2d Library in Hawthorne.

- On the weekend of October 4-5, 2008, associate **Tanja J. Fagan** will participate in the Avon Walk for Breast Cancer in New York City. She strives to raise more funds than last year and has set a personal goal of \$3,000.

- **Arnold D. Litt** and **Nilufer O. DeScherer** recently acted as purchaser's and borrower's counsel on the \$23,550,000 acquisition of the Carlyle, a 128-unit luxury hi-rise apartment building in Hackensack, New Jersey. Litt and DeScherer also recently closed another 1031 like kind exchange transaction involving the \$11,750,000 sale of a 70-unit apartment building in Red Bank, New Jersey.

Federal Estate Tax

The federal estate tax credit, currently at \$2 million, is set to increase to \$3.5 million in 2009. This means that in 2009 you can leave up to \$3.5 million to your heirs without any federal estate tax liability.

If Congress takes no action, the federal estate tax will be repealed altogether in 2010. While this is an unlikely scenario, it does underscore the uncertainty involved in estate planning over the next few years. **Our estate planning department can help you evaluate these and other estate planning issues. Please contact Andrew J. Cevasco or Louis C. Tomasella.**

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- First-party business interruption, covering lost revenue experienced during downtime due to accidents or security breaches (but typically not losses due to catastrophic regional power outages);
- First-party electronic data damage, such as the compromise of data from a virus infection;
- First-party extortion, including the demands made by hackers;
- Third-party network security liability, arising from compromise and

misuse of data stemming from identity theft and credit-card fraud;

- Third-party network liability in the form of court judgments obtained by persons harmed by problems originating with a business's computer system; and
- Third-party media liability, aimed at the full range of potential liability from matter published in interactive online communications.

For more information about these types of litigation risks or any other litigation matter, please feel free to contact Jason T. Shafron or Scott D. Jacobson.

Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects, but rather to provide insight into legal developments and issues. The reader should always consult with legal counsel before taking action on matters covered by this newsletter.

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In this day and age when income taxes are substantial and ever-increasing, estate planning techniques are extremely important in attempting to preserve wealth and assets. Moreover, other tax deferral techniques such as Section 1031 tax free exchanges have enabled property owners to avoid the payment of taxes in a properly qualifying 1031 Exchange. However, these techniques in many instances have required transitioning of existing entities to new entities in order to maximize the estate planning and 1031 tax saving opportunities. As the Supreme Court has now held, this may jeopardize existing title insurance coverage, thereby relieving title companies of their title coverage obligations in the event of post-closing claims.

However, there are mechanisms including title insurance endorsements that can be procured that will prevent termination of coverage in the event of subsequent transfer of title:

- As pointed out by the Supreme Court, a transfer by way of a warranty deed as opposed to a bargain and sale deed with covenant against grantor's acts will result in continuing coverage for the benefit of the insured. That is the case because with a warranty deed the grantor is warranting title to subsequent purchasers. This is contrasted with a bargain and sale deed in which the grantor only represents that it has not created a title defect. In the context of a warranty deed, the title policy coverage continues notwithstanding the transfer to another entity because the grantor remains liable for a breach of any covenants. However, in *Shotmeyer* the deed of conveyance was a bargain and sale deed. The Court noted that "the defect in title existed before the general partnership purchased the land", so the covenant in the bargain and sale deed did not control, since the grantor did not create the title defect. Simply stated, a warranty deed will protect against title insurance termination upon transfer to another entity.

However, this exposes the grantor to continual liability to subsequent purchasers for title defects. Thus, one has to weigh possible liability exposure with the possible termination of title insurance.

- For policies issued before 2007, there is an endorsement known as Successors and Transferees Coverage Endorsement ("S&TCE"), which expands the definition of insured to include related entity transferees for nominal consideration and has the effect of continuing coverage in favor of certain grantees who acquire title at a point in time after the policy is issued. The endorsement may be obtained at the time the policy is issued or at a subsequent date. The cost is 20% of the original premium if issued after closing and 10% of the original premium if issued simultaneously with the policy.

- The new ALTA Owner's Policy (2006) expands the definition of insured to include certain related entity transferees, including the following:

- A. successor to the title of the insured by operation of law as distinguished from purchase, including heirs, devisees, survivors, personal representatives, or next of kin;
- B. successors to an insured by dissolution, merger, consolidation, distribution, or reorganization;
- C. successors to an insured by its conversion to another kind of entity;
- D. a grantee of an insured under a deed delivered without payment of actual valuable consideration conveying the title.

1. if the stock, shares, memberships, or other equity interests of the grantee are wholly owned by the named insured,
2. if the grantee wholly owns the named insured,
3. if the grantee is wholly-owned by an affiliated entity of the named insured, provided the affiliated entity and the named insured are both wholly-owned by the same person or entity, or
4. if the grantee is a trustee or beneficiary of a trust created by a

written instrument established by the insured named in Schedule A of that title policy for estate planning purposes.

- The "Fairway" Endorsement. This endorsement is named after the Court's holding in *Fairway Development Co. vs. Title Ins. Co. of Minn.*, 621 F. Supp. 120 (N.D. Ohio 1985) (Court holding that a successor partnership had no insurable interest under title insurance policy with respect to an alleged defect in title to the property where two partners in an existing general partnership transferred their interest to the remaining partner who, in turn, entered into a new partnership bearing the same partnership name and where the original partnership was dissolved). If a Fairway Endorsement is in place, a general partnership or LLC is protected against lapse of title insurance coverage resulting from a change in the membership of the partnership or LLC, or from any resulting dissolution. Some title companies may insert strict limitations in the Fairway Endorsement that may vary from case-to-case and must be read closely by the insured. The cost is approximately \$50.00 and the endorsement issues simultaneously with the title policy.

In conclusion, it is extremely important that sellers and buyers of real estate retain competent real estate counsel to analyze for them any potential pit falls of a discontinuation of title insurance based upon their post-closing conveyance plans, so as to provide them with the best continuity of coverage available.

In the meanwhile, let us hope that the New Jersey State Legislature will intervene to cure some of the potential inequities that may have arisen in connection with transfers for nominal consideration in the context of estate planning and tax free exchanges.

Should you have any questions with regard to the above in general or as specifically applied to your particular situation, please feel free to contact Arnold D. Litt or Susan M. Marra.