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TITLE SEARCHES: TORT LIABILITY IN CALIFORNIA

Title insurance companies in California play a vital part in what is generally the most significant investment of a layman's life—his investment in a home.¹ In such situations the buyer understandably needs assurance that he is getting good title. Customarily the vendor or his agent procures a preliminary report of title and makes it available to prospective buyers. The buyer by perusal of this report becomes acquainted with the present state of title. If he is satisfied, the sale is consummated with the procurement of a policy of title insurance.² The title insurance generally issues from the company that prepares the preliminary report and it insures the title as portrayed in that report.³

This comment deals with the liability of a title company, apart from the contract of insurance, for negligently prepared preliminary reports. More specifically, it focuses upon the liability of a title company to third parties—those not in privity with the title company. In the normal land sale transaction a vendee is a third party since usually the contract to search is between the vendor or his agent and the title company. The comment also discusses the emerging trends in the law of negligent misrepresentation in analogous fields where there are contractual undertakings that generally affect third parties. Finally, the effect of exculpatory clauses and other methods of limiting liability is explored.

To minimize terminological misunderstandings, note that California courts refer to preliminary reports as abstracts of title, and to title companies (in their searching capacity) as abstracters.⁴ All such references in this comment are consistent with the judicial use.

THE NATURE OF THE DUTY

Contract Liability

Traditionally, the contract of employment limited the duty to search the records.⁵ The employer of the abstracter had a cause of action in contract for negligent search where he suffered damage as

¹ See Comment, 39 CALIF. L. REV. 235, 245 (1951).

² See generally *ibid.*

³ See generally Comment, 39 CALIF. L. REV. 235 (1951) to effect that searching the records in itself is seemingly not remunerative.

⁴ See, e.g., *Viotti v. Giomi*, 230 Cal. App. 2d 730, 41 Cal. Rptr. 345 (1964); *Hawkins v. Oakland Title & Guar. Co.*, 165 Cal. App. 2d 116, 331 P.2d 742 (1958); *J. H. Trisdale Inc. v. Shasta County Title Co.*, 146 Cal. App. 2d 831, 304 P.2d 832 (1956).

⁵ *Savings Bank v. Ward*, 100 U.S. 195 (1879).

a proximate result of the abstracter's negligence. The negligence was viewed as the breach of the employer-abstracter contract and the delivery of a negligent abstract as evidence of the breach.⁶ However, unless a person relying on the abstract could relate himself to the employer-abstracter contract on a valid contractual theory, he had no remedy against the abstracter.

The inequity of restricting the liability of abstracters or title companies to their contract of employment manifests itself in the decided cases. For example, V, intending to sell his land, procures a preliminary report from a title company. P purchases the land relying on the state of the title evidenced by the report. P later finds out that certain encumbrances actually existing on the property were omitted through the negligence of the title company and he is forced to discharge them. P, according to the weight of authority in the United States, has no cause of action against the title company because of lack of privity.⁷

Origin of Contract Liability

The case of *Savings Bank v. Ward*,⁸ decided in 1879, limited the liability of an abstracter to his contract of employment. The tenacity of *stare decisis* has preserved that doctrine to the present day. Decisions supporting the doctrine "speak the language of a time, when courts obliged to choose, were prone to prefer legal form before justice, and when the abstracter played little, if any, part in business negotiations."⁹ The public today is vitally concerned in securing dependable knowledge of titles, and since title companies have practically pre-empted the field of record searching, it is not unduly harsh to impose upon them a standard of reasonable care demanding skillfully prepared abstracts.

Liability in Tort

The landmark case of *Ultramares v. Touche*¹⁰ in 1931 refused to hold a public accountant liable in tort to a third party not in privity who incurred financial loss as a result of the accountant's negligent misrepresentation in the preparation of a balance sheet. The majority opinion, written by Justice Cardozo, said that, as a matter of public policy, accountants should not be exposed "to a liability in an indeterminate amount for an indeterminate time to

⁶ *Lattin v. Gillette*, 95 Cal. 317, 30 Pac. 545 (1892).

⁷ *Savings Bank v. Ward*, 100 U.S. 195 (1879); *Phoenix Title & Trust Co. v. Continental Oil Co.*, 43 Ariz. 219, 29 P.2d 1065 (1934).

⁸ 100 U.S. 195 (1879).

⁹ *Trusler, Extension of Liability of Abstracters*, 18 MICH. L. REV. 128 (1919).

¹⁰ *Ultramares Corp. v. Touche, Niven & Co.*, 255 N.Y. 170, 174 N.E. 441 (1931).

an indeterminate class."¹¹ Justice Cardozo refused to allow the assault on the citadel of privity. As long as public policy favored limited liability for negligent acts arising out of contractual relationships the concept of privity could be advanced as grounds for a decision.¹²

Public policy today, however, favors an imposition of duty on those people who hold themselves out to the public as possessing certain skills notwithstanding lack of privity. Thus, *Biakanja v. Irving*¹³ held a notary public liable in tort to a third party damaged by the notary's negligence in drawing up a will. New York, subsequent to *Ultramares v. Touche*, has held a certified public accountant liable in tort to a third party not in privity for negligence in the preparation of a balance sheet.¹⁴ In *Texas Tunneling Co. v. City of Chattanooga*,¹⁵ a federal court in Tennessee held consulting engineers, who made drawings for the city, liable in tort to a subcontractor who based his price for digging a sewer on the drawings. There was no privity. In California a soil tester for Central Contra Costa Sanitation District was held liable in tort to a third party who bid on the basis of the soil tests, despite lack of privity.¹⁶

The aforementioned cases illustrate that not only will an action lie where a misrepresentation arising out of contract rests on negligence, but also that the action may be maintained by a member of a class of persons whom the act may foreseeably affect rather than just those in privity. The concept of privity is seemingly giving way to public policy considerations of the proper scope of liability. It is submitted that a title company in preparing preliminary reports is no different than a soil tester, who knows that his tests will be relied upon by prospective bidders, and that in accord with emerging negligence law, title companies—as searchers—should be held to a standard of reasonable care to a foreseeable class.

THE TREND IN CALIFORNIA

The theory of contract as the sole basis of liability for negligent search was abandoned in the case of *J. H. Trisdale Inc. v. Shasta County Title Co.*¹⁷ in 1956. A third party was not involved. That

¹¹ *Id.* at —, 174 N.E. at 444.

¹² See Note, 48 VA. L. REV. 1476 (1962); Note, 16 VAND. L. REV. 266 (1962).

¹³ 49 Cal. 2d 647, 320 P.2d 16 (1958).

¹⁴ *Duro Sportswear, Inc. v. Cogen*, 131 N.Y.S.2d 20 (Sup. Ct. 1954), *aff'd mem.* 285 App. Div. 867, 137 N.Y.S.2d 829 (1955). An attempt was made to distinguish this case from *Ultramares v. Touche, Niven & Co.*; the unequivocal certification seems to have been the decisive factor in imposing liability. There was no fraud shown however.

¹⁵ 204 F. Supp. 821 (E.D. Tenn. 1962).

¹⁶ *M. Miller Co. v. Dames & Moore*, 198 Cal. App. 2d 305, 18 Cal. Rptr. 13 (1961).

¹⁷ 146 Cal. App. 2d 831, 304 P.2d 832 (1956).

case involved a misdescription of an easement of record by the title company in a preliminary title report. The report described the easement as belonging to Pacific Telephone and Telegraph Company when in fact it belonged to Pacific Gas and Electric. In overruling a demurrer for failure to state a cause of action in negligence that court said: "it would be strange, indeed, if prospective purchasers of real property could not rely on title reports for which they are required to pay, but must search the records themselves. If such be the law a large part of the value of title companies would disappear."¹⁸

The case of *Hawkins v. Oakland Title & Guarantee Co.*,¹⁹ decided in 1958, confirmed and expanded the tort liability suggested in *Trisdale*. A third party was not involved, there being the requisite privity between Hawkins and the title company. The case involved the omission by a title company in its preliminary report, of a grant of access rights to the State of California. The grant was of record. The purchaser upon acquiring the property built a service station worth \$25,000 in reliance on the accuracy of the preliminary report. The court, citing *Trisdale* as authority, reversed the sustaining of a demurrer in the lower court for failure to state a cause of action in negligence. In delineating the duty owed by a title company in searching the records, *Hawkins* viewed section 552 of the *Restatement of Torts* as determinative.²⁰ This section reads:

One who in the course of his business or profession supplies information for the guidance of others in their business transactions is subject to liability for harm caused to them by their reliance upon the information if

- (a) he fails to exercise that care and competence in obtaining and communicating the information which its recipient is justified in expecting and
- (b) the harm is suffered (i) by the person or one of the class of persons for whose guidance the information was supplied, and (ii) because of his justifiable reliance upon it in a transaction in which it was intended to influence his conduct or in a transaction substantially identical therewith.²¹

It is readily apparent that the elements of section 552 are present where a title company prepares a preliminary report for a vendor of land or his agent. The title company furnishes reports expressly for the guidance of purchasers. It can hardly be asserted that reliance on the reports is unjustifiable since the existence of an abstract or title report is directed to achieve reliance and nothing else. The foreseeability of harm to purchasers as a class is chargeable to the title

¹⁸ *Id.* at 839, 304 P.2d at 837.

¹⁹ 165 Cal. App. 2d 116, 331 P.2d 742 (1958).

²⁰ *Id.* at 126, 331 P.2d at 747.

²¹ RESTATEMENT, TORTS § 552 (1938).

company, since it in fact is aware that purchasers are generally the beneficiaries of its contract with the vendor.

The official comments to section 552 seem especially applicable in defining the care required in searching the record and to whom the duty of care extends. Part of comment (e) reads: "If the matter is one which requires investigation, the supplier of the information must exercise reasonable care and competence to ascertain the facts on which his statement is based."²² Comment (g) is as follows: "It is enough that the information is supplied for repetition to a particular class of persons and that the person relying on it is one of the class."²³ If section 552 of the *Restatement* determines the scope of a title searcher's liability, and *Hawkins* seems to indicate that such is the case, there is a liability to third parties not in privity.

Since, however, the *Hawkins* case did not involve a third party, the scope of 552, as binding authority, must be limited to the facts of that case. *Viotti v. Giomi*,²⁴ decided in 1964, commenting on liability for negligent search said: "recovery is now permitted either on the basis of contract or tort"²⁵ and cited *Hawkins* as authority. The *Viotti* case did not involve a third party.

EXTENSION OF TORT LIABILITY TO THIRD PARTIES

The tort duty announced in *Trisdale*, developed in *Hawkins*, and confirmed in *Viotti* has not been extensively defined. Although third parties were not plaintiffs in these cases, the language used by the courts, especially in *Hawkins*, seems broad enough to encompass them. How a third party will fare in such a suit remains to be seen. In view of the fact that it is customary for vendors to procure preliminary reports, thereby making the purchaser a third party vis-à-vis the title company, and considering the fact that title companies know that their expertise will be relied upon by purchasers and not vendors, it can reasonably be expected that recovery will be allowed. Public policy considerations of the proper scope of liability have changed significantly since *Ultramares v. Touche*. This change is amply illustrated in the cases from analogous fields—*e.g.*, soil tester, notary public, consulting engineers—that impose liability despite lack of privity.

THE EFFECT OF EXCULPATORY CLAUSES

The words "Preliminary report only—no liability hereunder" or "Liability hereunder limited to consideration paid" generally appear

²² RESTATEMENT, TORTS § 552, comment e (1938).

²³ RESTATEMENT, TORTS § 552, comment g (1938).

²⁴ 230 Cal. App. 2d 730, 41 Cal. Rptr. 345 (1964).

²⁵ *Id.* at 739, 41 Cal. Rptr. at 350-51.

conspicuously on preliminary reports. If by these clauses a title company is permitted to avoid liability for its negligent acts, the purchaser may rely on a title report only at his peril. Such words of exculpation on a litigation report were held not sufficient to excuse a title company for its negligence in *Viotti v. Giomi*.²⁶ The California Supreme Court in *Trunkl v. Regents of University of California*,²⁷ in invalidating an exculpatory clause in an agreement signed by plaintiff prior to admission to a hospital, suggested an outline of these transactions in which attempts at exculpation would be ineffective. Such a transaction

exhibits some or all of the following characteristics. It concerns a business of a type generally thought suitable for public regulation. *The party seeking exculpation is engaged in performing a service of great importance to the public which is often a matter of practical necessity for some members of the public.* The party holds himself out as willing to perform this service for any member of the public who seeks it, or at least for any member coming within certain established standards. As a result of the essential nature of service, *in the economic setting of the transaction, the party invoking exculpation possesses a decisive advantage of bargaining strength against any member of the public who seeks his services.* In exercising a superior bargaining power *the party confronts the public with a standardized adhesion contract of exculpation*, and makes no provision whereby a purchaser may pay additional reasonable fees and obtain protection against negligence. Finally as a result of the transaction, the person or property of the purchaser is placed under the control of the seller, subject to the risk of carelessness by the seller or his agents.²⁸

That the case of a title company in its searching capacity falls within the *Trunkl* doctrine seems unquestionable. A vendor who wishes to sell his home generally has no alternative but to approach a title company if he wants a report on the state of his title.²⁹ The vendor may not dictate the terms under which such a report issues. It is quite probable that a demand for terms, other than those on the printed form, would be unavailing. The court in invalidating the exculpatory clause in *Viotti* seems to indicate, in line with *Trunkl*, that public policy will not tolerate such evasions of liability. Since however, neither *Trunkl* nor *Viotti* involved third parties, the question of whether third parties are contemplated in the *Trunkl* doctrine has not yet been decided. If however the inequality of bargaining positions renders the excupatory clause void as against the party in privity, *a fortiori* a purchaser, who is forced to accept the report without any chance to object to the format, is entitled to protection. This is especially so since title companies cannot realistically assert

²⁶ *Id.* at 739, 41 Cal. Rptr. at 350.

²⁷ 60 Cal. 2d 92, 383 P.2d 441, 32 Cal. Rptr. 37 (1963).

²⁸ *Id.* at 98-101, 383 P.2d at 445-46, 32 Cal. Rptr. at 37-38. (Emphasis added.)

²⁹ See Comment, 71 YALE L. REV. 1161, 1171 & n.59 (1962).

lack of knowledge of the customary practice in real estate transactions, namely that the purchaser is really the party for whom the report is prepared regardless of the source of the consideration. It is submitted that since title companies perform such a vital public function and occupy such a superior bargaining power vis-à-vis the lay public, that as a matter of law exculpatory clauses should be ineffective to disavow liability.

*Effect of Provision Ten in the Conditions and Stipulations of the California Land Title Association Standard Coverage Policy of Title Insurance*³⁰

The great majority of land sale transactions in California culminate with the issuance of a policy of title insurance. The purchaser usually pays for this policy which insures the title shown in the preliminary report. Provision ten of the conditions and stipulations of the standard coverage policy reads in part:

Any action or actions or rights of action that the insured may have or may bring against the Company arising out of the title of the estate or interest insured herein must be based on the provisions of this policy.

No provision or condition of this policy can be waived or changed except by the writing endorsed hereon or attached hereto signed by the President, a Vice President, the Secretary, an Assistant Secretary or other validating officer of the Company.³¹

The effect of this provision may differ according to the person who orders the preliminary report. For example, where the vendor orders the report, the contract to search is between the vendor and the title company. Under present law the purchaser may not recover for negligent search for lack of privity. Therefore any cause of action of the purchaser is on the contract or insurance. If liability in tort extends to third parties, then section ten attempts to evade that liability. Similarly section ten attempts to evade tort liability where the purchaser orders the preliminary report. The institution of a tort liability will be to no avail and its extension to third parties meaningless if title companies, by their superior bargaining position, may circumvent their legal duty by a few lines of small print in their insurance policies.

CONCLUSION

The traditional immunity from suit of title companies for searching the records has withstood almost a century of progress in

³⁰ This standard policy is used by the vast majority of title insurance companies. For a clause similar to Provision Ten see the form in CALIFORNIA CONTINUING EDUCATION OF THE BAR, CALIFORNIA LAND SECURITY AND DEVELOPMENT, 182-87 (1960).

³¹ California Land Title Association Standard Coverage Policy.

jurisprudence. The consequences have been suffered by an unfortunate lay public. Society today is more solicitous of the individual's position and consequently extracts a higher duty from those people upon whom, because of their callings, others must rely. The present law of negligent misrepresentation, as many recent cases indicate, rests on a different philosophy than that of *Ultramares v. Touche*; today's courts think less in terms of no liability because the negligent party would thus be exposed "to a liability in an indeterminate amount for an indeterminate time to an indeterminate class."³² Rather their concern is more toward one harmed by the negligence of another, yet without recourse. The recent trend is toward allowing recourse to third party plaintiffs.

If *dicta* in recent cases concerning search liability of title companies can be fairly interpreted, it is likely that title companies will join that growing number of professions, who, as a consequence of holding themselves out as possessing certain skills, subject themselves to a standard of due care to a foreseeable class of plaintiffs. Title companies should not be permitted to abdicate or circumvent their legal duty by using their superior bargaining position. Only one act of negligence on the part of a title company can defeat a layman's life earnings. It is imperative that the public be provided with correct information on titles. Liability to third parties is a certain step in that direction.

Patrick R. McMahon

³² *Ultramares Corp. v. Touche, Niven & Co.*, 255 N.Y. 170, —, 174 N.E. 441, 444 (1931).