

LENDER'S MINERAL TITLE INSURANCE: A MINI-PRIMER

By Kraettli Q. Epperson

While owners' and mortgage title insurance of surface rights has been available in Oklahoma for many years, insurance of severed mineral rights held by an owner or lender is issued only in limited areas of the country and its use is not encouraged by the title insurance underwriters. It has been only within the last year or two that lender's mineral title insurance has become available in Oklahoma and, to my knowledge, owner's mineral title insurance is not yet being issued in Oklahoma.

This paper presents general information on lenders' mineral title insurance by describing what Oklahoma's statutes say about title insurance in general and by explaining the coverage and exclusions of a typical lender's mineral title insurance policy. There is no attempt herein to deal with the title examination process or the title risk decision making steps which go into issuance of such a policy.

1. WHAT IS TITLE INSURANCE?

According to Oklahoma Statutes (36 O.S. §§709 & 5004) title insurance is insurance or a guarantee (*i.e.*, indemnification) against loss suffered by the beneficiary (*i.e.*, owner or lender) due to encumbrance, defective title, invalidity of title or adverse claim.¹ The interplay of statutes, case law and policy terms creates an obligation upon the title insurer to both defend the beneficiary's interest and to pay for any actual loss suffered.

2. WHY USE LENDER'S MINERAL TITLE INSURANCE?

Many lenders will not make a loan where surface real property is used as collateral unless they have lender's title insurance. This is often true even

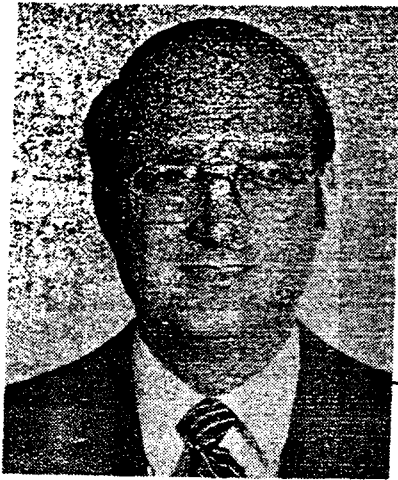
where they already have an attorney's opinion. Lenders who make development and operating loans backed up by severed mineral interests also are beginning to request such lender's title insurance. Title insurance is important especially in mineral transactions where the assignment of interest is without warranty by the assignor. The use of a nationally known title insurance underwriter also helps to overcome resistance from non-local lenders who may be unfamiliar with other states' laws on minerals and with local examining attorneys' skills and financial strength.

3. WHAT DOES A LENDER'S MINERAL TITLE INSURANCE POLICY COVER?

In general terms, the policy insures that the lender has a valid and first lien on the oil and gas leasehold estate interest owned by the borrower. This coverage protects against both hidden title defects, and those title defects of record which are missed by the abstractor or examiner. More specifically, the policy indemnifies the beneficiary-lender, up to the face amount of the policy, against actual loss and costs of defenses arising due to the following title defects:

- (1) Title to the estate or interest described in Schedule A (of the Policy) being vested otherwise than as stated therein;
- (2) Any defect in or lien or encumbrance on such title;

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failure of said assignment to vest title to the insured mortgage in the named insured assignee free and clear of all liens."²

- (3) Lack of a right of access to and from the land;
- (4) Unmarketability of such title;
- (5) The invalidity or unenforceability of the lien of the insured mortgage upon said estate or interest except to the extent that such invalidity or unenforceability, or claim thereof, arises out of the transaction evidenced by the insured mortgage and is based upon
 - (a) usury, or
 - (b) any consumer credit protection or truth in lending law;
- (6) The priority of any lien or encumbrance over the lien of the insured mortgage.
- (7) Any statutory lien for labor or material which now has gained or hereafter may gain priority over the lien of the insured mortgage, except any such lien arising from an improvement on the land contracted for and commenced subsequent to Date of Policy not financed in whole or in part by proceeds of the indebtedness secured by the insured mortgage which at Date of Policy the insured has advanced or is obligated to advance; or
- (8) The invalidity or unenforceability of any assignment, shown in Schedule A (of the Policy), of the insured mortgage or the

4. WHAT DOES THE POLICY EXCLUDE AND EXCEPT?

Generally speaking the lender's policy excludes and excepts from coverage any title matter arising subsequent to the policy's effective date and any matter arising from the operator's or lender's own actions. The policy specifically excludes from coverage the following matters:

- "(1) Any law, ordinance or governmental regulation (including but not limited to building and zoning ordinances) restricting or regulating or prohibiting the occupancy, use or enjoyment of the land, or regulating the character, dimensions or location of any improvement now or hereafter erected on the land, or prohibiting a separation in ownership or reduction in the dimensions or area of the land, or the effect of any violation of any such law, ordinance or governmental regulation.
- (2) Rights of eminent domain or governmental rights of police power unless notice of the exercise of such rights appears in the public records at Date of Policy.
- (3) Defects, liens, encumbrances, adverse claims, or other matters (a) created, suffered, assumed or agreed to by the insured claimant; (b) not known to the Company and not shown by the public

records but known to the insured claimant either at Date of Policy or at the date such claimant acquired an estate or interest insured by this policy or acquired the insured mortgage and not disclosed in writing by the insured claimant to the Company prior to the date such insured claimant became an insured hereunder; (c) resulting in no loss or damage to the insured claimant; (d) attaching or created subsequent to Date of Policy (except to the extent insurance is afforded herein as to any statutory lien for labor or material).

- (4) Unenforceability of the lien of the insured mortgage because of failure of the insured at Date of Policy or of any subsequent owner of the indebtedness to comply with adequate "doing business" laws of the state in which the land is situated."²

The standard exceptions in a lender's mineral policy include:

- "(1) Rights or claims of parties in possession not shown by the public records.
- (2) Encroachments, overlaps, boundary line disputes, and any matters which would be disclosed by an accurate survey and inspection of the premises.
- (3) Easements, or claims of easements, not shown by the public records.
- (4) Rights of the owners of the surface of the land herein described by virtue of their surface ownership.
- (5) Claims of damage to the surface, or any improvements thereon, caused by the exploration, drilling and removal of oil and/or gas, heretofore or hereafter.
- (6) Lack of oil and/or gas in place or underlying the surface of the land herein described, or prior removal of any oil and/or gas as might have formerly existed.
- (7) Taxes on the estate or interest insured herein.

- (8) Duties and obligations, express or implied, imposed by the lease creating the leasehold estate or interest herein insured.
- (9) Lack of a right of access to or from the estate or interest insured herein.
- (10) Any federal, state or local spacing, pooling or other regulatory or conservation laws.
- (11) Consequences of any dispute over the manner of exercise of any rights incidental to the exploration, drilling and removal of oil and/or gas from the land."²

5. WHEN SHOULD LENDER'S MINERAL TITLE INSURANCE BE USED?

While such a lender's mineral title insurance policy could be requested and issued at any stage in the acquisition and production process (e.g., at Drilling Opinion or Division Order Title Opinion stages), it is most likely that such a policy would be used to back up a financing or refinancing request to a lender based on reserves from a proven well.

6. WHO ORDERS THE INSURANCE AND WHO BENEFITS FROM IT?

The operator-lessee seeking such financing would order the policy showing its lender as the beneficiary. While there is not an active promotion by underwriters of a policy to the owner-lessor or lessee on their ownership interest at the current time, this type of coverage will probably be available in the not too distant future.

7. WHAT IS THE LENDER'S MINERAL TITLE INSURANCE POLICY BASED ON?

According to Oklahoma Statutes (36 O.S. §5001(c)) a policy of title insurance can be issued only "after examination of a duly certified abstract of title prepared by a bonded and licensed abstractor."³ Therefore, each policy is founded on and backed up by both a certified abstract of title and an attorney's examination.

8. HOW ARE MULTIPLE TRACTS HANDLED?

If there are multiple tracts being mortgaged, the face amount of the policy will be allocated on a

definite dollar basis among the various tracts. (Example: If there was a \$10,000,000 policy and 6 tracts, then proration might result in 5 tracts being allocated \$1 million each with \$5 million designated as the coverage on the 6th tract.)

9. WHAT DOES SUCH TITLE INSURANCE COVERAGE COST?

The risk rate premium (over and above the cost of abstracting and examination) for lender's mineral title insurance begins at \$5.00 per thousand dollars of coverage and decreases in a stair-step fashion until it reaches \$3.00 per thousand dollars of coverage for that portion of coverage over \$500,000.00.⁴

In conclusion, the introduction of lender's title insurance to Oklahoma has just begun, but will probably continue to grow in use due to increased caution in institutional lending of money on mineral interests.

1. 36 O.S. §709—"Title Insurance" defined: "Title insurance" is insurance of owners of property or others having an interest therein, or liens or en-

cumbrances thereon, against loss by encumbrance, or defective title, or invalidity, or adverse claim to title.

36 O.S. §5004—"Title Insurance Policy" defined:

A "title insurance policy" is any written instrument purporting to show the title to real or personal property or any interest therein or encumbrance thereon, or furnish such information relative to real property, which written instrument in express terms purports to insure or guarantee such title or the correctness of such information.

2. From Chicago Title's Oil and Gas Leasehold Lender's Policy.

3. 36 O.S. §5001(c)—Qualifications of title insurers: C. Every policy of title insurance or certificate of title issued by any company authorized to do business in this State shall be countersigned by some person, partnership, corporation or agency, actively engaged in the abstract of title business in Oklahoma as defined and provided in Title 1, Oklahoma Statutes Annotated, or by an attorney licensed to practice in the State of Oklahoma duly appointed as agent of a title insurance company, provided that no policy of title insurance shall be issued in the State of Oklahoma except after examination of a duly certified abstract of title prepared by a bonded and licensed abstracter as defined herein. (Emphasis added.)

4. From Chicago Title's January 1, 1982, Risk Rate Chart for an Oil and Gas Leasehold Lender's Policy.

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