



**AMERICAN ARBITRATION ASSOCIATION  
Commercial Arbitration Tribunal**

**Case Number 01-18-0002-9482**

**PennyMac Mortgage Investment Trust Holding I, LLC**

Claimant

**v.**

**Fidelity National Title Insurance Company**

Respondent

**RULINGS ON INTERIM MOTIONS AND INTERIM AWARD**

I, the undersigned Arbitrator, having been designated in accordance with the arbitration agreement entered into between the above-named parties as of April 22, 2005, and having been duly sworn, and having duly heard the proofs and allegations of the Parties, do hereby issue this INTERIM AWARD, as follows:

**PROCEDURAL BACKGROUND OF THE PENDING MOTIONS**

With my consent, both Claimant PennyMac Mortgage Investment Trust Holding I, LLC (“PennyMac”) and Respondent Fidelity National Title Insurance Company (“Fidelity”) have submitted motions to be heard concurrently. They are pre-hearing motions often referred to as “*Montrose*” motions, after the leading case of *Montrose Chemical Co. v. Superior Court* (1993) 6 Cal.4<sup>th</sup> 287 (“*Montrose*”).

This matter and these motions arise out of a lawsuit by Beatriz Carbajal (the “Carbajal Lawsuit”) in which Carbajal alleged that a deed of trust of which PennyMac is the current beneficiary is invalid or unenforceable. In response to that lawsuit, PennyMac, the policyholder under a policy of title insurance

originally issued to PennyMac's predecessor, Access by Fidelity's predecessor, Lawyers Title Insurance Company ("the Policy"), tendered the claim by Carbajal to Fidelity under the Policy. Fidelity ultimately denied any obligation to indemnify PennyMac or to provide a defense of the Carbajal Lawsuit to PennyMac. PennyMac thereupon commenced this arbitration seeking damages for breach of the policy and other relief.

PennyMac now moves for summary adjudication (or partial summary judgment) establishing that there was a potential for coverage of the Carbajal Lawsuit under the Policy and therefore Fidelity was obligated to provide a defense to PennyMac, with the ultimate coverage dispute reserved for later resolution once the underlying lawsuit has been resolved. Fidelity concurrently moves for a final award (or summary judgment) on the ground that there is neither actual coverage nor a potential for coverage under the Policy that triggered Fidelity's obligation to provide a defense to PennyMac, so Fidelity is entitled to an award as a matter of law.

Each party submitted briefs and evidence in support of its motion and in opposition to the other party's motion. On January 8, 2020, a hearing on the motions was held at the office of the Arbitrator. PennyMac appeared by Linda Kornfeld of Blank Rome LLP and Fidelity appeared by Christopher I. Ritter of Early Sullivan Wright Gizer & McRae LLP. At the hearing, I<sup>1</sup> requested, and the parties submitted, supplementary briefs and replies regarding certain specified issues raised in the oral argument.

Having read and considered the briefs and supporting evidence, reviewed the key legal authorities cited by the parties, and heard oral argument, I now rule on the motions as set forth below and issue my Interim Award.

### **RULING ON THE MOTIONS**

For the reasons set forth below, the motion of PennyMac for interim relief is DENIED and the motion of Fidelity for an award as a matter of law is

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<sup>1</sup> It is my custom, followed here, to couch awards, tentative or final, in the first person. This is more natural, makes it easier to clearly express ideas and conclusions, and avoids the kind of stilted and often archaic language of passive or third party formats.

GRANTED. This ruling shall therefore constitute the interim award, with a final award coming after the issue of attorneys' fees is resolved (see the final paragraph below).

### **FACTUAL BACKGROUND**

The following facts material to these motions are generally undisputed and are taken from the declarations submitted in connection with the two motions, the documents and other evidence, the briefs of the parties, and any facts agreed by counsel in oral argument. Given the general absence of dispute as to the facts, I will not spend the time citing specific sources in the materials for the facts cited.

This recitation is meant as a summary of the key facts and is not intended to be exhaustive. To the extent there was a dispute as to the existence of a fact, its recitation here is a determination of that dispute. Other facts might be material but not recited here, and all of such facts are deemed to be found to be in support of the rulings here.

In 2004, Jennifer Soliman obtained a loan from First City Funding dba Credit Corp. ("First City") of \$307,500 ("the Loan"). The Loan was evidenced by a promissory note from Soliman to First City ("the Note") and secured by a deed of trust in favor of First City encumbering the real property located at 18032 Flynn Drive, Unit 5404, Canyon Country, California ("the Trust Deed"). On May 14, 2009, First City assigned the Note and the Trust Deed to JP Morgan Chase Bank, NA, which on September 14, 2013, assigned the Note and Trust Deed to PennyMac. The validity and priority of the Trust Deed were insured by a title insurance policy issued to First City in 2005 by Lawyers Title Insurance Company ("the Policy"). Fidelity is the successor in interest to Lawyers Title.

On March 28, 2014, PennyMac recorded a notice of default under the Note, thereby commencing foreclosure on the Trust Deed. The property was then owned by Beatriz Carbajal, who tendered the notice of default to her own insurer, Westcor Land Title Insurance Company ("Westcor"). When Westcor denied coverage (the basis of the denial is not disclosed), Carbajal filed a lawsuit in the federal court in which she sought to quiet her title in the

property. This action is Carbajal v. HSBC Bank, U.S.A., NA et al., Central District of California case no. 2:16-cv-9297 PSG (“the Carbajal Lawsuit”).

The complaint in the Carbajal Lawsuit did not name PennyMac as a defendant, but PennyMac nevertheless tendered the lawsuit to Fidelity under the Policy. Fidelity denied coverage on the ground that the claim was premature, but in her First Amended Complaint, and later in her Second Amended Complaint, Carbajal added PennyMac as a defendant.

The First Amended Complaint, and later the Second Amended Complaint (the latter is referred to herein as “the Complaint”), alleged as against PennyMac that the Trust Deed was invalid because the Loan had never actually funded. There was no allegation of any other basis (including any equitable basis) for Carbajal’s contention that the Trust Deed was invalid.

On February 7, 2017, PennyMac tendered the First Amended Complaint (which first named PennyMac) to Fidelity, which denied coverage by letter of March 8, 2017. The denial was primarily based upon the allegation in the Complaint that the Loan had not been funded by First City, citing *First American Title Ins. Co. v. XWarehouse Lending Corp.* (2009) 177 Cal.App.4<sup>th</sup> 106 (“XWarehouse”). On May 21, 2018, PennyMac’s counsel wrote to Fidelity insisting that Fidelity’s denial of coverage and refusal to provide a defense to the Carbajal Lawsuit were breaches of the policy. On June 12, 2018, Fidelity responded by reiterating its prior denial and the grounds for the denial and asserting various provisions of the Policy.

PennyMac provided and paid for its own defense and, prior to the trial, made the business decision to mitigate its damages by settling with Carbajal for a payout of the remaining balance of the Note of \$250,000. As a result, PennyMac ultimately received \$220,790.93 less than the total amount due on the Note. PennyMac also had incur legal fees and related costs in defense of the Carbajal Lawsuit, which it claims total \$507,336.95.

#### **THE FIDELITY POLICY and THE CONTENTIONS OF THE PARTIES**

The Policy issued by Lawyers Title to First City in 2005 is applicable to this claim, as it covers PennyMac as the assignee of the Note and the Trust

Deed. See §2(a) of the Conditions and Stipulations. Lawyers Title was subsequently acquired by, and is now a part of, Fidelity. There is no dispute that Fidelity is bound by the provisions of the Policy and that PennyMac is now the insured policyholder under the Policy.

Coverage 5 of the Policy provides coverage for any claim of “The invalidity or unenforceability of the lien of the insured mortgage upon the title.” While the Complaint alleges that the Trust Deed is invalid or unenforceable, Fidelity emphasizes that the only ground of such alleged invalidity is the failure of the original lender (First City) to actually fund the Loan. If the Loan was in fact not funded by First City, it would appear that there is no coverage of the Carbajal Lawsuit under the Policy per the holding in *XWarehouse*.

PennyMac argues that (i) the allegation that the Loan was unfunded is untrue and that the mere allegation in the Complaint might be, and ultimately was, disproved, (ii) there was therefore a potential that the claim would be covered by the Policy, depending upon the resolution of the key disputed issue in the Carbajal Lawsuit, (iii) this potential for coverage required Fidelity to provide a defense to the claim until the question of funding was conclusively established one way or the other (presumably by a judgment in the Carbajal Lawsuit), (iv) there were other possible ways for the Trust Deed to be found unenforceable or subordinate to later-recorded deeds of trust, and (v) this created a duty on the part of Fidelity to provide, and therefore reimburse PennyMac for, the defense of the lawsuit and to indemnify PennyMac for the amount paid to Carbajal to settle the claim.

Fidelity, in support of its contention that there was no potential for coverage, relies primarily on *XWarehouse* and some of the cases cited in that decision, primarily a couple of non-California cases. PennyMac contends that *XWarehouse* does not apply here because in *XWarehouse*, the loan was admittedly not funded, whereas here, there was at the time of the tender of the Carbajal Lawsuit a dispute as to whether the Loan actually funded.

## ANALYSIS

### 1. The Burden of Proof as to Each Motion

In order to prevail, PennyMac need prove only that the Carbajal Lawsuit was potentially covered under the Policy, even if that potential was remote or unlikely, and regardless whether coverage was ultimately found to exist. Fidelity, in order to prevail, must show that “...the third party complaint “*can by no conceivable theory raise a single issue which could bring it within the policy coverage.*” *Montrose* at 300 [citing *Gray v. Zurich Insurance Co.* (1966) 65 Cal.2nd 263, 276 fn 15; emphasis by the Court in *Montrose*].

“[F]acts known to the insurer and extrinsic to the third party complaint can generate a duty to defend, even though the face of the complaint does not reflect a potential liability under the policy.” *Id.* at 296 [citing *Gray v. Zurich Ins. Co., supra*]. See also *Horace Mann Insurance Co. v. Barbara B.* (1993) 4 Cal.4th 1076, 1081 [“Facts extrinsic to the complaint also give rise to a duty to defend when they reveal a possibility that the claim may be covered by the policy” (citation and internal quotation marks omitted)].

The complaint in the Carbajal Lawsuit alleged a single basis for the claim that the Trust Deed was unenforceable – that the proceeds of the original Loan had not been paid to Soliman (the borrower). PennyMac contends that there were other possible grounds for coverage under the Policy, including at least one equitable ground. However, the Complaint did not allege any such equitable claim or other ground, nor is there any evidence that any other ground was ever asserted by Carbajal.

Fidelity’s obligation is measured by the allegations of the Complaint and any other facts known to Fidelity at the time the claim was tendered. *Montrose* at 295-296. Such a theoretically possible claim cannot serve as the basis for requiring an insurer to provide a defense just in case such a claim is made later. If that occurs, the policyholder can re-tender the lawsuit to the insurer (which is, in fact, what happened here).

## **2. The Key Issue – Whether This Claim is Controlled by *XWarehouse***

### **A. Introduction**

The only basis, as Fidelity acknowledges, for rejecting PennyMac's tender of the Carbajal Lawsuit and the Complaint was the allegation that the Loan had not been funded. However, unlike the situation in *XWarehouse*, the truth of that allegation was undetermined at the time of the tender. The key question, then, is whether that difference is material; the resolution of these motions hinges upon the answer to that question.

### **B. The Facts and Holding of *XWarehouse***

Simplifying the facts of *XWarehouse* somewhat, CHL, which acted in substance as a loan broker, committed to make real estate secured loans to several borrowers, which loans were initially to be funded by lender referred to as Access. Access' funding was to be replaced by the funds of the individual investors that would be procured by CHL. Pursuant to that program, CHL arranged for a loan to Esparza and one to Gill. The escrows for each of those loans closed with funds from Access, the funding being conditioned upon the receipt by Access of a lender's title policy from First American Title for each loan insuring the validity and priority of the trust deed securing each loan.

In fact, Access' loan proceeds were paid out of escrow not to previous trust deed holders or to the borrower, but to CHL. The borrowers, naturally, made no payments to Access, as they did not know anything about Access and had not received any loan proceeds (one borrower established that the note and trust deed were forgeries). Access was unable to foreclose on its trust deeds, and CHL was in bankruptcy.

Access tendered a claim for the amount of the loan to First American, which had issued the title insurance policy to Access as required by the escrow instructions. First American denied coverage and filed a declaratory relief action against Access (by then known as *XWarehouse*). The trial court found that no coverage existed, because the loans were not funded, and the appellate

court affirmed.

The appellate court held that “Because there was no transfer of funds between CHL and the named borrowers...that created an indebtedness secured by the insured mortgages, Access does not meet the definition of an insured under First American’s title insurance policies.” *Id.* at 116-117. The court explained that “Any losses suffered by Access are not due to defects in the title or mortgage liens, but are entirely due to the failure of an existing indebtedness between the named borrowers and CHL.” *Id.* at 117.

In *XWarehouse*, the failure to fund the loans was established and not subject to dispute by the time of the tender to the insurer. The court pointed out that there were only two possibilities: (i) if the loans had not funded, “The liens would not be subject to foreclosure because no indebtedness existed between the named borrowers and CHL. Alternatively, if the named borrowers had received the benefit of the loans, then the deeds of trust would have been enforceable. Consequently, the losses suffered by Access are not the result of the invalidity or unenforceability of the lien of the insured mortgage upon the title.” *Id.* at 117 (citations omitted).

Fidelity presents the same two possibilities in its opening brief (at 1-2) and in its denial letter of March 8, 2017. Fidelity asserts that if the First City loan was not funded, PennyMac would not be an insured, because there would be no indebtedness, so there would be nothing to secure and nothing to insure. The lack of indebtedness is not the result of any failure of the Trust Deed, but of the underlying debt, which Fidelity does not insure. Fidelity then asserts that if, as PennyMac claims, the Loan was in fact funded, the Trust Deed is enforceable, and there is no loss to PennyMac, so coverage, if it arguably existed, would be excluded under Exclusion 3(c).

**C. The Factual Distinction Between this Case and *XWarehouse* is Immaterial**

*XWarehouse* is the only California case addressing this issue. The facts are remarkably similar to the facts of this case. The single material factual difference – that in *XWarehouse* the absence of funding of the original loan was



established, while here it was disputed – creates the main issue in this case. PennyMac contends that this distinction makes *XWarehouse* inapplicable while Fidelity contends that it is applicable and is controlling.

For the reasons set out below, I conclude that the factual difference between *XWarehouse* and this case is not material to the outcome. The reason for that conclusion is not necessarily apparent either in the *XWarehouse* opinion or in the discussion of the issue in this case, or perhaps one can say that it is implied or “understood,” even if not explicit. However, that implicit principle is the centerpiece of the *XWarehouse* holding.

The opinion in *XWarehouse* concentrates on the distinction between the obligation on the promissory note and that based upon the deed of trust. The court points out the well-established principle that a title insurance policy insured only the validity of the deed of trust and not the note secured by that deed of trust.<sup>2</sup> While that distinction is an essential part of the reason that there was no actual or potential coverage in *XWarehouse*, that is only part of the story. The reason that PennyMac’s emphasis on the distinction between this case and *XWarehouse* is immaterial is that PennyMac, as did the court in *XWarehouse*, ignores (or simply skips over) the definition of “coverage.”

When PennyMac tendered the Complaint to Fidelity, the allegation that the original loan was unfunded was just that – an allegation, and it was disputed by PennyMac. That is what led to this claim. Had the alleged reason for the claimed invalidity of the trust deed not been alleged (assuming that could be done in a quiet title action), it is possible that Fidelity would have had to provide a defense, at least until the absence of funding was clarified as the basis of the claim.<sup>3</sup>

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<sup>2</sup> The court in *XWarehouse* pointed out (at p. 113, fn 5) that Insurance Code §12390(a) authorizes a title insurer to insure the “identity, due execution and validity of any note or bond secured by mortgage ...” but that the First American policy did not have that provision. The Policy here similarly omits that provision.

<sup>3</sup> The use by Carbajal of the descriptor “quiet title” would not, as PennyMac believes, alone be sufficient to bring the action within coverage. It would depend upon the facts alleged in the text of the complaint if such facts were alleged, as they were in the

However, even in that case, once it was established that the only basis for the quiet title claim against PennyMac was the failure of the Loan to fund, the matter would then be in the identical situation as here. That is, Fidelity would have been required to reimburse PennyMac at least for defense costs between the date of tender and the recognition that the absence of funding was the sole basis for Carbajal's claim against PennyMac). However, that did not occur; the Complaint made it clear at the outset that the sole basis for attacking the validity or priority of the Trust Deed was the claim that the Loan had not been funded. There is no evidence that Carbajal's position ever changed in that regard.

Based upon the Complaint, there were only two possible outcomes of the factual dispute as to whether the Loan was funded: either the loan was funded or it was not funded. This is the same situation as *XWarehouse* discussed, stating, arguably in dictum, that it did not matter whether the funding was established at the time of the tender, because either way, the title insurer would have had no obligation to pay money (that is, to indemnify the policyholder for loss). *Id.* at 117.

There is no evidence that suggests that there was a reason other than the nonfunding of the Loan that was a basis for finding that the Trust Deed was unenforceable. The Complaint controls, and Fidelity is not obligated to guess what other kind of claim Carbajal might make in the future. *Gunderson v. Fire Insurance Exchange* (1995) 1106, 1114; *Low v. Golden Eagle Ins. Co.* (2002) 99 Cal.App.4th 109, 113. Therefore, *XWarehouse* controls the outcome here unless there is a material distinction between the two cases. I conclude that there is no material distinction and that *XWarehouse*, even if not as clear as it could be, controls the outcome here.

### **3. The Holding of *XWarehouse* was Correct and Controls This Case**

The opinion in *XWarehouse* lays out the law applicable to this case.

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Carbajal Complaint. See, *Ulrich v. State Farm Fire & Casualty Co.* (2003) 109 Cal.App.4th 598.

PennyMac contends that *XWarehouse* is inapplicable here because in that case, there was no dispute that the loan was unfunded, while in this case, that was only an allegation, and it ultimately proved to be untrue. In PennyMac's view, the existence of that factual dispute meant that there was some potential for coverage. PennyMac's position is in truth based largely upon the absence of an explanation in *XWarehouse* of the underlying reason that there was no potential for coverage there. That reason is the meaning of the term "coverage" and particularly in the context of a title insurance policy.

In *Montrose* and virtually all of the published decisions in this area following *Montrose* (that is, discussing the circumstances in which an insurer is obligated to provide a defense for a claim that is only potentially covered), the test is whether at the time of the tender to the insurer there was a "potential for coverage." However, those cases do not discuss what is meant by "coverage" or by the statement that a claim is "covered."

"Insurance is a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event." Insurance C. §22. "The person who undertakes to indemnify another by insurance is the insurer, and the person indemnified is the insured." Ins. C. §23. "Indemnity is a contract by which one engages to save another from a legal consequence of the conduct of one of the parties, or of some other person." Civil Code §2772.

A popular dictionary defines "indemnity" as "1. protection or insurance against loss, damage, etc., 2. legal exemption from penalties or liabilities incurred by one's actions. 3. repayment or reimbursement for loss, damage etc.; compensation." Webster's New World Dictionary of the American Language, College Edition, at p. 740. Another online dictionary defines "indemnity" as "a sum of money paid as compensation..." The online Law Depot Blog defines "indemnity" as follows: "In its simplest form, indemnity means that one party in the contract is responsible for compensating another for loss, damages, and/or injury incurred as a result of that party's actions."

The essence of each of these definitions is that “indemnify” means “pay an obligation owed by another.” In the insurance context, it means to pay money either to or on behalf of the policyholder.<sup>4</sup> This scope of indemnity – that is, the kinds of claims that trigger an insurer’s obligation to pay money -- is what is meant by “coverage.”

This inescapable conclusion lies at the heart of the issue here. PennyMac contends that Fidelity was obligated to provide a defense of the Carbajal Lawsuit because there was a potential for coverage – that is, as discussed above, the obligation to pay money either to Carbajal or to PennyMac itself. However, as the court in *XWarehouse* points out, the title insurer in Fidelity’s situation had no possible obligation to pay money, whether to the claimant or to the policyholder.

Here, had the Loan not been funded, there would be no obligation secured and nothing for Fidelity to insure. If the loan had in fact been funded, there would be no defect in the trust deed, and Fidelity would not have to pay any money either to Carbajal or to PennyMac. Either way, Fidelity had no obligation pay money - in other words, no obligation to indemnify PennyMac regardless how the funding issue was resolved. There was no possible outcome of the dispute over funding that would have required Fidelity to pay money and therefore no potential for coverage.

The result in *XWarehouse* and here results from the unique nature of a title insurance policy and the peculiar nature of its indemnity obligation. In the end, the issue is whether Fidelity had a potential obligation to pay money either to Carbajal to settle the case or to PennyMac if the case was tried and lost. Because under no circumstances would Fidelity have had an obligation to pay money to or on behalf of PennyMac, the Carbajal Lawsuit was not a

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<sup>4</sup> Insurance is a form of risk transfer, whereby the policyholder pays a (usually) one-time fee (the premium) and in exchange, the insurer assumes the risk of having to pay to defend the policyholder or pay for any loss incurred by the policyholder that is within the scope of the indemnity. There are policies that provide only defense costs, rather than indemnity, but these are rare and are not seen in the title insurance area.

“covered” claim. In the absence of a potential obligation to pay money, there was no potential for coverage.

#### **4. Conclusion – Fidelity’s Motion is Granted and the Interim Award**

##### **A. Ruling on the Motions**

For the reasons set out above, PennyMac’s motion must be, and it is, denied, and Fidelity’s motion must be, and it is, granted.

##### **B. This is an Interim Award**

Since this determination, as the parties agreed during the oral argument, resolves all of the issues presented for arbitration, it is appropriate to issue a final determination on the merits. However, in view of the attorney fee provision in the Policy (see below), this will be an interim award.

##### **C. Attorneys’ Fees and Costs**

The arbitration agreement (§13 of the Conditions and Stipulations of the Policy) provides “The award may include attorneys’ fees only if the laws of the state in which the land is located permit a court to award attorneys’ fees to a prevailing party.” AAA Rule 47(d)(ii) provides for such an award, and Civil Code §1717 provides for such an award if the contract includes such a provision. AAA Rule 47(c) provides that the Arbitrator may allocate and award his compensation, as well as other expense, in the award.

The briefing schedule is as follows:

- Fidelity shall have until April 20, 2020 to submit a request for attorneys’ fees or notify me that no such award will be sought. A request for fees should include the reasons why Fidelity is entitled to an award of attorneys’ fees and the amount of such award if made. It should include all of the evidence Fidelity contends supports its entitlement to an award and the amount of such an award.
- PennyMac shall have until May 4, 2020 in which to submit a response to the application both as to entitlement and amount.
- Fidelity shall have until May 8 to submit any reply, which should not include any new evidence.

- The matter will thereupon be submitted without any further hearing, and when determined, a Final Award shall be issued encompassing this Interim Award and the award, if any, of attorneys' fees and costs.

This Interim Award shall remain in full force and effect until such time as a final Award is rendered.

Dated: April 8, 2020



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Alan R. Jampol, Arbitrator