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Arbitration determines responsibilities under policy, statement of understanding

By Andrea Golby

A landowner brought claims against its title insurer for breach of contract and bad faith for alleged violations of its obligations under a title insurance policy to compensate the landowner for actual losses resulting from a defect in title and to reimburse the full amount of attorney's fees incurred by the landowner in defending against the title claim asserted by a third party.

The title insurer denied liability and brought a cross-complaint for damages for alleged fraudulent inducement. It argued that agents of the landowner knew of and failed to disclose a material off-record title claim to an interest in the property prior to the issuance of the title insurance policy. It sought restitution of all that it had paid to or on behalf of the landowner.

On August 8, 2013, the U.S. District Court for the Central District of California confirmed the arbitration award in the case, *First American Title Insurance Co. v. Lochland Holdings LLC (No. 11-01861) (AAA Case No. 72 159 Y 00274 11)*.

Lochland Holdings LLC obtained a $6.8 million title policy underwritten by First American Title Insurance Co. on May 15, 1998, which insured portions of an assemblage of eight contiguous parcels of land in Makena, Maui, Hawaii. The 14 acre Lochland estate is one of the most exclusive ocean front residential properties in Maui, with a present value estimated to range from $40 to $50 million.

Before the policy was issued, Lochland's attorney, Tom Leutenecker had obtained a quiet title judgment against certain native Hawaiian descendants in Hawaii state court. However, after that judgment was entered, but still before the policy issued, Leuteneker was allegedly informed by certain other native Hawaiian descendants that they also had off record claims of ownership to portions of the property. Hawaii law provides for a hearsay exception allowing native Hawaiians to bring quiet title claims based on off record family genealogical information (whether oral or written). This information was not brought to First American's attention and the policy issued. In November 1998, six months after the policy issued, Lochland tendered a claim under the policy, which First American accepted. First American retained Hawaii counsel to represent Lochland in the underlying quiet title action, which lasted approximately eight years until it was settled through mediation in January 2006. The settlement quieted title to the insured portion of the Lochland estate which was in dispute. As part of the consideration for the underlying settlement, Lochland contributed an uninsured parcel from its estate to the native Hawaiians.

In February 2006, First American and Lochland memorialized their respective obligations with regard to the consideration paid to settle the underlying action in a statement of understanding (SOU). The SOU included a cap on any sums Lochland could later seek from First American in connection with the settlement of the underlying action. The SOU also included an arbitration provision and provided that one of the issues that could be arbitrated was the amount of attorney's fees that would be payable to Lochland for the fees Lochland had paid to Leuteneker.

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In April 2011, Lochland initiated arbitration against First American with the American Arbitration Association in Los Angeles, seeking millions of dollars of additional compensatory damages, disregarding the SOU and its damages cap. Lochland asserted that the uninsured ocean front parcel that it contributed to the underlying settlement in order to help quiet title to the insured parcel, was worth millions of dollars and was part of its actual losses. First American maintained that the SOU, and its damages cap, was valid and binding and controlled the issues. Lochland disagreed, arguing that the SOU was neither valid nor binding.

In response to Lochland's filing of the demand for arbitration, First American filed a complaint for declaratory relief in the U.S. District Court for the Central District of California. The insurer sought a declaratory ruling that any arbitration between the parties with respect to the benefits to be paid to Lochland under the policy should be governed by the terms of the SOU, and that the scope of any arbitration should be governed by the SOU, rather than the policy's broader provisions.

Lochland moved to dismiss First American's complaint or, in the alternative, to compel arbitration pursuant to the Federal Arbitration Act and stay proceedings on the complaint pending arbitration.

The court declined to exercise its discretion to dismiss the complaint, did not rule on the validity of the SOU, and instead limited its ruling to ordering that the case should be arbitrated pursuant to the arbitration provision in the policy. The case then went before a panel of three arbitrators of the American Arbitration Association pursuant to the arbitration provision in the policy.

Lochland submitted an amended claim to the arbitration panel for breach of contract and breach of duty of good faith and fair dealing, seeking approximately $26 million in compensatory and punitive damages.

First American filed a statement of cross-claims with the AAA, asserting claims for 1) fraudulent inducement to enter the policy, contending that Lochland had pre-policy knowledge of the very off record title defect for which it sought indemnification in the arbitration; and 2) a determination of the scope of Lochland's coverage, if any, under the policy, including a determination of the validity of the SOU.

After three weeks of arbitration involving the testimony of more than 20 witnesses (from Hawaii, Colorado and California), the arbitration panel determined that the policy was superseded in part by the SOU and that the SOU (and its damages cap) is a valid and binding agreement between the parties. It also determined that Lochland is not entitled to any compensatory damages given that First American had already paid more than Lochland's indemnifiable loss in 2007 at the time of the underlying settlement. The panel also determined that even assuming that the SOU had not been valid, Lochland's valuations of the ocean front parcel in question (that it contributed to the underlying settlement) were vastly inflated, when analyzing the facts to the law that addresses valuation of actual loss under a title policy.

"First American was obligated to cover Lochland's actual loss pursuant to the indemnity provision of the policy," the arbitration panel said in its final award. "It in fact contributed $500,000 toward the [underlying 2007] settlement of the title dispute concerning Grant 2074, and subjected itself, in the SOU, to the obligation to contribute more (up to a limit of $525,000) in the event it was adjudicated that the $500,000 contribution was insufficient to cover the loss."

"The policy itself did not impose on First American any obligation to determine, and offer in settlement, an amount equivalent to the loss resulting from the title defect," the panel stated. "It is sufficient, under the policy, for First American to defend against the claim and remain

willing to cover the loss if necessitated by an adverse outcome at trial – that is, to restore at that time the monetary difference between the amount the insured in fact paid to purchase the land, and the amount it would have paid for the same land had the title defect been known. The scope of that policy obligation did not change by the event of First American voluntarily offering, in the midst of [the underlying quiet title] litigation, an amount less than the plaintiff's large demand. The insured had the unfettered option either to: i) end the litigation then by itself contributing the balance needed to meet the demand or ii) to continue to receive a defense through trial (and coverage thereafter in the event of a loss). Had Lochland opted to settle by contributing that balance, and done nothing else, First American's duties would be at an end. Full ownership of the land would have been restored in a way that the insured had opted for. There would have been nothing more required of the insurer under the policy."

Ultimately, the panel determined that notwithstanding Lochland's request for approximately $6 million in compensatory damages and $20 million in punitive damages, that First American owed Lochland a grand total of $133,892.00 for a portion of the fees incurred by Lochland's counsel, Leuteneker during his involvement in the underlying action -- a number proposed by First American as the reasonable value of the services provided by Leuteneker in the underlying quiet title litigation.

First American was represented by Eric P. Early, Scott Gizer and Peter Scott of Early Sullivan Wright Gizer & McRae LLP in Los Angeles. Lochland was represented by James Riddle, Charles Coleman and Adanna Love of Holland & Knight in San Francisco. Mr. Early stated that, "The arbitration panel was very thorough in its analysis and findings. Its 39 page final opinion and award were consistent with the facts and the law and we are gratified by the result. First American more than honored its obligations under the policy to this wealthy insured, and was correct in standing up for its rights, notwithstanding the pressures that the insured brought to bear to try to extract a huge payday for which it was not entitled."