

2003

# Vestin Mortgage, Inc. v. First American Title Insurance Company, a California corporation : Reply Brief

Utah Court of Appeals

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**IN THE UTAH COURT OF APPEALS**

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VESTIN MORTGAGE, INC.,

Plaintiff and Appellant,

vs.

FIRST AMERICAN TITLE  
INSURANCE COMPANY, a  
California corporation,

Defendants and Appellees.

No. 20030941-CA

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**REPLY BRIEF OF APPELLANT**

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Appeal From the Third Judicial District Court, Salt Lake County  
Case No. 20030941-SC, Honorable Frank G. Noel

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## INTRODUCTION

Vestin Mortgage, Inc. ("Vestin") hereby submits this Reply Brief to the Brief of Appellee ("Opposition Brief") of First American Title Insurance Company ("First American").

A significant portion of the Opposition Brief argues that the assessment levied by Eagle Mountain City ("Assessment") did not constitute a lien on the property subject to Vestin's trust deeds ("Property") at the time the title insurance policies ("Policies") were issued by First American. Vestin does not dispute that no assessment lien existed on the Property at the time the Policies were issued. Indeed, as made abundantly clear, Vestin specifically has stated it is not making such an argument. (Appellant's Brief 22 n.7, stating that "Vestin does not claim coverage under either the 'lien' or 'encumbrance' provisions of the Policies.")

The existence of a lien, contrary to First American's argument, is not relevant to the issues raised by Vestin in this appeal, i.e., whether various insuring clauses contained in the Policies, when read in conjunction with the "governmental police power" provisions, afford coverage to Vestin for "defects," "incorrectness" and "other matters." First American ignores basic tenets of contract interpretation and fails to address coverage of Vestin's claims under the various insuring clauses of the Policies. First American similarly ignores the "police power" provision in the Policies and, based on the incorrect premise that the Eagle Mountain Special Improvement District ("Eagle Mountain SID") and Notice of Intention do not constitute the exercise of police power for



purposes of coverage under the Policies, summarily dismisses as inapplicable the exception to the police power exclusion.

Vestin's interpretation of the Policies, consistent with rules of contract interpretation, affords meaning to each insuring provision in the Policies, as well as harmonizes these provisions with the exception to the exclusion for the exercise of governmental police power. The trial court's ruling incorrectly dismissed Vestin's claims and should accordingly be reversed and this case remanded for further proceedings.

### **ARGUMENT<sup>1</sup>**

#### **I. FIRST AMERICAN FAILS TO ADDRESS COVERAGE OF VESTIN'S CLAIMS UNDER THE PERTINENT INSURING PROVISIONS OF THE POLICIES**

##### **A. The Issue of Whether a Lien Existed on the Property at the Time of Issuance of the Policies is Irrelevant to Coverage of Vestin's Claims**

Section I of First American's argument (Opposition Brief 14-20) contains a lengthy argument that a lien did not exist at the time the Policies were issued. This argument, while correct, has no bearing on whether Vestin's claims are covered because the Eagle Mountain SID and the Notice of Intention, regardless of their status as a "lien," constitute a "defect," "incorrectness" or "other matter" under the insuring clauses of the Policies. Because Vestin does not dispute that the Assessment was not levied and did not constitute a lien on the Property until after the date of issuance of the Policies, Section I

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<sup>1</sup> First American claims that on appeal Vestin has pursued a new avenue to create a pre-policy argument for coverage. (Opposition Brief 12). In fact, Vestin has not modified its argument in any fashion on appeal. (Opposition Brief 29). Vestin continues to argue, as it did in the district court, that the creation of the Eagle Mountain SID is a title "defect," "incorrectness" and "other matter" affecting title and is covered by the Policies. (R. 235-238).

of the Opposition Brief is not mostly irrelevant to whether the Policies afford coverage to Vestin under the various insuring clauses of the Policies.

Section II of First American's argument purports to address whether the Eagle Mountain SID and the Notice of Intention constitute a "defect" under the Policies. (Opposition Brief 20-21). This section, however, is merely a reiteration of First American's argument regarding whether a lien existed on the Property. The authority cited by Vestin to support its argument that no "defect" existed primarily relate to whether a "lien" existed for purposes of coverage under the Policies. For example, First American cites to I Joyce D. Palomar, Title Insurance Law § 5.5: at 5-21 (2003) ("*Palomar*"), in support of its argument that no defect existed. (Opposition Brief 22). *Palomar*, however, merely states that a prospective assessment does not constitute a "lien or encumbrance" under a title insurance policy—a fact that Vestin does not dispute. The citation from *Palomar* relied upon by First American does not state, nor does it address, whether the recorded notice of the exercise of a police power constitutes a "defect" for purposes of title insurance coverage. Here, as throughout the Opposition Brief, First American glosses over the fact that a "lien" is something different than a "defect," "incorrectness," or "other matter" under the Policies. Because the meaning of the terms in the insuring provisions of the Policies are separate and distinct from the terms "lien" and "encumbrance," First American's reliance on authority focusing only "liens" or

“encumbrances” is not pertinent to a determination of whether Vestin’s claims, as framed, are covered under the Policies.<sup>2</sup>

**B. First American Ignores Basic Rules of Contract Construction in Interpreting the Insuring Provisions of the Policies**

First American applies its arguments, which are relevant only to the term “lien” as used in the Policies, equally to the term “defect” by lumping the words “lien,” “encumbrance” and “defect” together as having the same meaning. First American offers no direct support for such a position, and merely notes that “courts use the terms defect, lien, and encumbrance interchangeably.” (Opposition Brief 25 n.10). The interchangeable use of the words by some courts does not mean the words have the same meaning. Indeed, it is for this very reason that courts must interpret title policies according to their specific terms and avoid reliance on cases not addressing the provisions at issue. *See New England Federal Credit Union v. Stewart Title Guarantee Co.*, 765 A.2d 450,453 (Vt. 2000) (“Furthermore, policies and policy language may vary. A closer, contextual examination of the policy is therefore necessary to resolve the issue before us.”); *Manor Real Estate v. Zamoiski Co.*, 246 A.2d 240, 245 (Md. App. Ct. 1968) (noting that courts tend to improperly equate or confuse liens with encumbrances).

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<sup>2</sup> First American states that the Notice of Intention, among other things, “advised that Eagle Mountain City intended to create the Special Improvement District.” (Opposition Brief 9). However, in fact, when the Notice of Intention was recorded in the public records it had attached to it Resolution 14-00, dated August 1, 2000, which actually created the Eagle Mountain SID. (R. 230, 304-306). Accordingly, the Notice of Intention gave public notice of the prior creation of the Eagle Mountain SID. First American also claims that Resolution 14-00 did not mention assessments. (Opposition Brief 9). In fact, Section 4 of the Resolution states that the properties will be assessed. (R. 304-305). Likewise, the Notice of Intention, which is referred to in the Resolution, also discloses the future assessments. (R. 304).

Basic rules of contract construction require that the terms in the insuring provisions of the Policies be given their separate, plain and ordinary meanings. *See Stewart Title Guaranty Co. v. Greenlands Realty, L.L.C.*, 58 F. Supp.2d 370, 382 (D.N.J. 1999) (“Moreover, if defect was synonymous with “unmarketability,” there would be no reason for the policy to list both terms.”). Further, basic rules of contract construction provide that contracts must be interpreted to give effect to every word in the contract. *See Musser v. Bank of America*, 964 P.2d 51, 54 (Nev. 1998). It is impermissible for a court to interpret a contract so as to render any part of the contract meaningless. *Id.*; *see also Plateau Mining Co. v. Utah Div. of State Lands & Forestry*, 802 P.2d 720, 725 (Utah 1990) (“Each contract provision is to be considered in relation to all of the others, with a view toward giving effect to all and ignoring none.”). Finally, contracts should be interpreted to avoid “neutralizing or ignoring a provision or treating it as surplusage.” *Hawthorn Land Co. v. Equilon Pipeline Co., LLC*, 309 F.3d 888, 894 (5<sup>th</sup> Cir. 2002). First American’s interpretation imputing the definition of the term “lien” to other provisions of the Policies renders all but the term “lien” meaningless and mere surplusage in the Policies.

“Lien” is defined as “a claim, encumbrance or charge on property for payment of some debt, obligation or duty.” *Blacks Law Dictionary* 635 (6<sup>th</sup> ed. 1991).

“Encumbrance” is defined as “any right to, or interest in, land which may subsist in another to diminution of its value, but consistent with the passing of the fee by conveyance.” *Id.* at 364. The term “defect” has the much broader meaning of “the want or absence of some legal requisite; deficiency; imperfection; insufficiency. The absence

of something necessary for completeness or perfection . . . .” *Id.* at 289; *Bel-Air Motel Corp. v. The Title Ins. Corp.*, 444 A.2d 1119, 1121-22 (N.J. Sup. Ct. 1981). As argued in Vestin’s opening brief, a defect is something, however slight or trivial, that renders title free from doubt. *See Stewart Title Guaranty Co. v. Greenlands Realty, LLC*, 58 F. Supp.2d 370, 382 (D.N.J. 1999). In this case, the Eagle Mountain SID and the Notice of Intention, although not rising to the level of a “lien” on the Property, constitute a “defect” and therefore a deficiency in the disclosures made in the Policies falling within the terms of the insuring provisions of the Policies.

In interpreting the word “defect,” First American notes that it is defined as something that subjects property to claims of others or when property is subject to the claims of a third party. (Opposition Brief 21). As noted by First American, the very reason for the creation of a special improvement district is “for public purposes with the power to levy taxes for the limited purpose of the district.” *See Tygeson v. Magna Water Co.*, 119 Utah 274, 280, 298, 226 P.2d 127, 131, 139 (1950). The creation of the Eagle Mountain SID, along with the recorded Notice of Intention, subjected Vestin’s Property to claims by a third party—the Eagle Mountain City—for improvements to be made within the SID. Indeed, the Eagle Mountain SID and the recording of the Notice of Intention would not have been undertaken but for the purpose of assessing charges to the property located within the boundaries of the SID. Because Vestin’s property was subject to the claims of Eagle Mountain City pursuant to the Eagle Mountain SID, a covered “defect” existed at the time the Policies were issued.

First American argues that under the circumstances of this case, the rule of construction that a policy is interpreted in favor of the insured and against the insurer is inapplicable. (Opposition Brief 36 n.14). To support this claim, First American relies on *Falmouth Nat'l Bank v. Ticor Title Ins. Co.*, 920 F.2d 1058, 1062 (1st Cir. 1990). However, the *Falmouth* court only stated that the rationale behind interpreting an insurance policy against the insurer “would not seem to apply as strongly” when the transaction is between parties of equal sophistication and bargaining power. The case does not stand for the proposition that the rule of construction in favor of the insured does not apply in certain circumstances. Rather, the court in *Falmouth* recognized that the principle of construction still applies, but perhaps not as strongly. Furthermore, in the *Falmouth* case, as in other cases with similar holdings, the parties actually negotiated specific terms of the policy. *Id.*; see also *First State Underwriters Agency of New England Reinsurance Corp. v. Travelers Ins. Co.*, 803 F.2d 1308, 1311-1312 (3d Cir. 1986) (“[T]he principle that ambiguities in policies should be strictly construed against the insurer does not control the situation where large corporations, advised by counsel and having equal bargaining power, are the parties to a negotiated policy.” (Emphasis added)). Further, courts have distinguished the principle advanced by First American in cases similar to this case:

The proffered evidence does not demonstrate that Eagle-Picher had unusual sophistication with respect to liability insurance, or that its small corporate insurance department allowed it to bargain as an equal with insurance industry representatives. Certainly the offer of proof does not show that Eagle-Picher “had so actively participated in drafting [the policies] that it should be denied the benefit of the usual rule” of construction in favor of the insured.

*Eagle-Picher Industries, Inc. v. Liberty Mut. Ins. Co.*, 682 F.2d 12, 21 (1st Cir. 1982).

Likewise, in this instance, First American cannot show that Vestin negotiated the Policies or that the usual rules of construction should otherwise not apply.

**C. The Eagle Mountain SID and the Notice of Intention Caused Injury to and Damage to Vestin**

In Section I.C. of its argument, First American asserts that the Eagle Mountain SID and the Notice of Intention are not covered under the Policies because Vestin did not suffer any harm until the Assessment was levied on the Property. (Opposition Brief 19-20). First American asserts that the Eagle Mountain SID and the Notice of Intention are inconsequential and that arguing that the Eagle Mountain SID negatively affects title is akin to arguing that Eagle Mountain City negatively affects title. (Opposition Brief 20). This argument is belied by First American's own actions in disclosing that the Property is located within Eagle Mountain City. In fact, First American recognizes that Eagle Mountain City negatively affects Vestin's lien because Eagle Mountain City is disclosed in the Policies in Schedule B-Part I, "Exceptions from Coverage" which states:

This property lies within the boundaries of Eagle Mountain City and is subject to all charges and assessments levied hereunder. (A check was made and none were found.)

(R. 107). Furthermore, First American did disclose and except from coverage in a preliminary title report a special improvement district, which was the wrong district. (R. 233, 359). Significantly, First American in fact excepted from coverage the Eagle Mountain SID in the policy issued to Integrated Financial Services. (R. 234, 396-97).

First American's actions therefore contradict its argument that the Eagle Mountain SID does not negatively impact Vestin and does not need to be excepted from coverage.

First American's argument that the Eagle Mountain SID and Notice of Intention caused no harm to Vestin ignores case law cited by Vestin confirming that the recorded notice of a future assessment constitutes damage under a title insurance policy. In *Bel-Air Motel Corp. v. The Title Ins. Corp.*, 444 A.2d 1119 (N.J. Sup. Ct. 1981), the court held that although an improvement assessment had not been levied at the time the title insurance policy was issued, "Bel-Air . . . bought its property subject to a liability: the obligation to pay the assessment when its amount was fixed, an obligation which would ripen into a lien when the assessment was confirmed." *Id.* at 1122.<sup>3</sup>

In this case, Vestin, like the plaintiff in *Bel-Air*, was subject to the future Assessment by virtue of the creation of the Eagle Mountain SID and the Notice of Intention regarding the Assessment. The fact that the actual amount of the Assessment was not determined until after the date of the Policies is of no moment. The Eagle Mountain SID and the Notice of Intention recorded in the public records subjected Vestin's Property to claims by Eagle Mountain for the improvement Assessment, thereby

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<sup>3</sup> The *Bel-Air* court further stated:

Bel-Air's property was subject to a definite liability. It would be assessed for part of the cost of the local improvement. The assessment, when confirmed, would become a lien against the property. These circumstances prevented the title to the property from being "relatively free from doubt." At a minimum, it is obvious that Bel-Air would have been exposed to litigation concerning its title if it challenged the assessment or decided to press a claim against the seller for its payment. Title, therefore, was not marketable and [the insurer] became liable for any loss occasioned by that circumstance.

*Id.* at 1123.



causing damages, the amount of which was determined upon the adoption of the Assessment Ordinance and levy of the Assessment Lien.

Similarly, in *United Fire & Casualty Co. v. Fidelity Title Ins. Co.*, 258 F.3d 714 (8<sup>th</sup> Cir. 2001), the court held that a notice of claim against the insured property, whether valid or not, caused injury because such a claim *might* force a person into litigation. *See id.* at 719. The prospect of future litigation, though not inevitable, was a covered “defect” under the policy. *See id.*

As established by the case law, the fact that a “defect” causes future damage which may not be definite or fixed does not preclude coverage under a title insurance policy. Rather, a flaw in title that subjects an insured to injury at some future time is a covered “defect.” In this case, the existence of the Eagle Mountain SID, as well as the Notice of Intention, subjected Vestin to claims by Eagle Mountain for improvement assessments. The fact that the exact amount of the assessments had not yet been determined does not mean that Vestin has not suffered injury and loss due to the covered defects.<sup>4</sup>

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<sup>4</sup> First American argues that since Vestin will benefit from the improvements it will not sustain any damage, and, therefore, First American should not be obligated to compensate Vestin. Interestingly, the Policies insure against “[a]ny assessments for street improvements under construction or completed at Date of Policy which now have gained or hereafter may gain priority over the insured mortgage....” This provision specifically imposes liability on First American for a future assessment, even if the landowner benefits from the street improvement. The issue addressed by this provision is very analogous, if not the same, to the facts in this case. In any event, the issue of damage was not an issue raised in First American’s Motion to Dismiss, and is therefore not before this Court. Also, the claim is not supported by any citation to fact. The only evidence before the Court is that Vestin has sustained a compensable loss and injury. (R. 232-34). If Vestin has benefited by the assessments or improvements, then, in such event, Vestin’s damage claim will be reduced accordingly. As noted in *Palomar* § 5:5, 5-22, a benefit from a special assessment reduces the recoverable damages. This issue must be resolved by trial.

**D. Case Law Relied Upon by Vestin Supports Coverage Under the Policies for “Defects”**

In Section II.B. of its Opposition Brief, First American argues that authority relied upon by Vestin in interpreting the term “defect” does not support Vestin’s interpretation of the Policies. (Opposition Brief 27-28). For example, First American contends that the definition of “defect” in the *Stewart Title* case does not support Vestin’s claim. In fact, the “defect” at issue in that case was much less significant than the Eagle Mountain SID and the Notice of Intention. In that case, a “scriveners” or typographical error left some doubt as to whether title to a certain strip of land was conveyed along with a larger portion of land. The *Stewart Title* court held that although the error was not one that affected marketability of title, the error, however trivial, nonetheless constituted a “defect” in title and was therefore covered under the title insurance policy. *See Stewart Title*, 58 F. Supp. 2d at 382. In this case, the existence of the Eagle Mountain SID and the Notice of Intention are much more of a “defect” than a simple typographical error not affecting title to property. In contrast, the Eagle Mountain SID and the Notice of Intention clearly effect title by subjecting Vestin to claims by Eagle Mountain against its property for improvements.

First American further argues that interpretation of the word “defect” in *United Fire & Casualty Co. v. Fidelity Title Ins. Co.*, 258 F.3d 714 (8<sup>th</sup> Cir. 2001), does not support coverage for Vestin’s claim in this appeal. The term “defect,” as defined in *United Fire & Casualty*, confirms that the Eagle Mountain SID and the Notice of Intention are covered defects under the Policies. In that case, the court held that the term

defect is defined as “any fault or shortcoming or failing.” *See id.* at 719. The court further held that the term “defect,” which was not defined in the policy, must be given its plain and ordinary meaning and could not be construed according to the insured’s narrower and more technical interpretation of the word. *See id.* at 720. There, a claim against title, “regardless of validity,” constituted a “defect” under the policy. *Id.* at 719.

In this case, First American attempts to apply the more specific meaning of the word “lien” to the term “defect” under the Policies. Rules of contract construction, as well as case law interpreting the term “defect,” prohibit such a construction.

Coverage of Vestin’s claim depends on interpretation of the term “defect,” as well as the other insuring clauses discussed hereafter. First American, however, ignores this portion of the Policy that insures against “defects” and instead bases its arguments solely on the term “lien” under the Policies. First American’s failure to differentiate between the definitions of different words in the Policies is fatal to its position. This Court should properly conclude that the creation of the Eagle Mountain SID and the Notice of Intention constituted a “defect” covered under the Policies.

## **II. CASE LAW RELIED UPON BY FIRST AMERICAN DOES NOT SUPPORT ITS POSITION**

### **A. The Authority Relied Upon by First American Does Not Address Coverage Under the Policies in this Case**

First American argues that case law and treatise authority overwhelmingly support its position. (Opposition Brief 22-28). However, none of the cases relied upon by First American address the “police power” clause. As discussed further below, the “police power” provision is central to the interpretation of coverage in this case. Because the

cases relied upon by First American do not address that issue, they are not pertinent to an interpretation of the policy language at issue in this case. In addition, the cases relied upon by First American are otherwise distinguishable from this case. For example, the policy at issue in *Edwards v. St. Paul Title Ins. Co*, 563 P.2d 979 (Colo. Ct. App. 1977), contained a specific exclusion for tax liens which had not been levied at the time the policy was issued. The policy in that case provided that “the company *does not*, by this policy, *insure*, including: “Taxes and assessments not yet due or payable and Special Assessments not yet certified to the Treasurer’s office.” *Id.* at 980 (emphasis in original). Such a provision is not at issue in this case. In addition, in the *Edwards* case, there was no recorded notice of the exercise of governmental police power and the concomitant notice of intent to levy taxes on the property. Because *Edwards* does not address the issues raised by Vestin for coverage under the Policies, the case should accordingly be disregarded by this Court.

Similarly, the holding in *Strass v. District-Realty Title Ins. Corp.*, 358 A.2d 251 (Md. Ct. Spec. App. 1976), was specifically limited to whether the assessment at issue in that case constituted “liens” on the subject property. In determining that the title insurance policies at issue in that case did not cover the assessments *as liens*, the *Strass* court recognized that the definition of liens and encumbrances are not necessarily co-extensive and that in some circumstances, assessments that have not become a lien on property may nonetheless constitute an encumbrance on property. *See id.* at 257 (emphasis in original). Thus, the *Strass* case is inconsistent with First American’s conclusion that the terms “defect,” “lien” and “encumbrance” are interchangeable in the context of title insurance.

Other cases relied upon by First American also fail to address the issue in this case, i.e., whether a recorded notice of the exercise of police power and a prospective assessment constituted a “defect” under the Policies or an event covered by the other insuring clauses in the Policies. *See Butcher v. Burton Abstract & Title Co.*, 216 N.W.2d 434 (Mich. Ct. App. 1974) (addressing only whether assessments constituted “liens” or “encumbrances” under the policy); *Cole v. Home Title Guaranty Co.*, 244 N.E.2d 470 (N.Y. Ct. App. 1968) (same); *Medeiros v. Guardian Title & Guaranty Agency, Inc.*, 387 N.E.2d 644 (Ohio Ct. App. 1978) (holding that assessment lien constituted a “special assessment” under real estate purchase agreement).

The cases relied upon by First American address a common scenario in which a title insurance policy, without regard to the police power provision, covers a pre-policy liens. Such is the not issue in this case. This case deals with a unique situation where the insuring clauses must be read in light of coverage provided for the recorded notice of the exercise of governmental police power.<sup>5</sup>

#### **B. First American Fails to Distinguish Case Law Relied Upon by Vestin**

First American argues that *Bel-Air Motel Corp. v. The Title Ins. Corp.*, 444 A.2d 1119 (N.J. Sup. Ct. 1981), which is relied upon by Vestin in its opening brief, supports its interpretation of the Policies. To the contrary, *Bel-Air*, unlike the cases relied upon First

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<sup>5</sup> In its footnote 9, First American argues that Vestin incorrectly suggests that the *Edwards* court did not address the prospective assessment as a title “defect.” (Opposition Brief 24). In fact, however, Vestin argued that the *Edwards* court did not address the issue of a title defect in the context of the police power exception, which it clearly did not do. (Appellant’s Brief 23). First American’s contention further highlights the fact that it simply ignores the “police power” exception throughout its Brief, even when purporting to respond to Vestin’s arguments based upon the police power exception.

American, interprets the insuring clause of the policy which is substantially similar to the Policies at issue in this case, in conjunction with the exclusion to the exception for the exercise of governmental police power. In holding that the policy provided coverage for an assessment which had not become a lien at the time of issuance of the policy, the court harmonized the policy's requirement of coverage for existing "defects" with the required coverage for a recorded exercise of governmental police power. *See id.* at 1122.

Similarly in this case, the only interpretation of the Policies which harmonizes the insuring provision with the police power provision is one that affords coverage to Vestin.

First American fails to address the holding in *New England Federal Credit Union v. Stewart Title Guarantee Co.*, 765 A.2d 450 (Vt. 2000). Like *Bel-Air*, the *New England* court found that a recorded notice of the exercise of governmental police power was covered under a police power provision similar to the provision at issue in this case. *New England* is further instructive as it specifically notes that courts often inappropriately use the terms "defect," "lien" or "encumbrance" interchangeably, requiring a close contextual examination of the language of an insurance policy. *See id.* at 453. Further, the *New England* court stated that cases addressing policies that do not include a police power provision "are of limited value" because of the differences in policy language. *See id.* at 454. As noted above, the cases relied upon by First American do not interpret the crucial language and policy provisions at issue in this case and are therefore inapposite to the issues before this Court.

### **III. FIRST AMERICAN HAS FAILED TO ADDRESS COVERAGE OF VESTIN'S CLAIMS UNDER THE "POLICE POWER" PROVISION IN THE POLICIES**

**A. First American Acknowledges that the Eagle Mountain SID and the Notice of Intention Constitute Exercise of the Police Power**

First American cites various portions of both the *Palomar* treatise and Barlow Burke, *Law of Title Insurance* (3<sup>rd</sup> ed. 2000) (“*Burke*”), and claims that those treatises do not support the position of Vestin. (Opposition Brief 22-23) First American, however, ignores those portions of the treatises which specifically address the police power provision at issue in the Policies, which recognize the general rule of liability: that the exercise of police power that is of public record is a covered event. According to both of those treatises, if the governmental action is recorded in the public records prior to the issuance of the policy, the insurer is liable under the policy unless the notice is excluded from coverage. As noted in *Palomar*:

Title policies do cover insured’s losses resulting from governmental police powers to the extent that a notice of the exercise thereof ... was recorded in the public records prior to the policy date.

*Palomar* at 6-13. See also *Burke*, § 4.02[B] at 4-27 (“However, notwithstanding the exclusion, the insurer is liable when a notice of the exercise of police power either “has been recorded” (the 1990 version) or appears (the 1970 version) in the public records at the Date of Policy.”).<sup>6</sup>

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<sup>6</sup> First American states that Vestin did not specifically plead the police power provision in its Complaint. (Opposition Brief 29). Copies of the Policies, which include the police power provision, were attached and incorporated into the Complaint. Specific reference to the police power provision in the Complaint is not required under Utah’s notice pleading requirements. See Utah R. Civ. P. 8(a); *Valdez Fisheries Dev. Ass’n v. Alyeska Pipeline Serv. Co.*, 45 P.3d 657, 674 (Alaska, 2002) (“[A] complaint gives the defendant sufficient notice if it generally alleges that a contract existed and was breached in a way that damaged the plaintiff.”); *Zattiero v. Homedale Sch. Dist. No. 370*, 51 P.3d 382, 386 (Idaho 2002).

First American contends that the levy of the Assessment was a “separate and distinct” exercise of governmental police power—suggesting that it agrees that the creation of the Eagle Mountain SID and the recorded Notice of Intention also constitute the exercise of governmental police power. (Opposition Brief 30). First American fails to explain, however, why the adoption of the Ordinance creating the Eagle Mountain SID and the Notice of Intention, as opposed to the Assessment Ordinance and levy of the Assessments, would not fall within the language of the police power provision of the Policies. The Policies provide coverage for the exercise of “[a]ny governmental police power . . .” that is recorded in the public records. There is no qualifying language that suggests that notice of “preliminary action” is not a covered event. First American’s acknowledgment that the creation of the Eagle Mountain SID and the Notice of Intention constitute the exercise of police power confirms that Vestin’s claim is covered under the police power provision of the Policies.<sup>7</sup>

**B. First American Improperly Concludes that Only the Assessment Lien Constitutes the Exercise of Police Power**

First American also argues that the creation of the Eagle Mountain SID and the Notice of Intention do not constitute the exercise of the governmental police power. (Opposition Brief 31). First American ignores the plethora of authority cited by Vestin in

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<sup>7</sup> First American argues that Vestin incorrectly states that the trial court concluded that the creation of the Eagle Mountain SID was not an exercise of police power, and that Paragraph 4 of the Order only recites that the Notice of Intention “was not a notice of the exercise of a governmental police power.” (Opposition Brief 30). The distinction that First American attempts to make is without difference. Clearly, the Notice was a notice of the creation of the Eagle Mountain SID. The ordinance creating the SID is part of the Notice of Intention. If the Notice of Intent is not a notice of the exercise of police power, as First American contends, then the only reasonable conclusion is that the Court found that creation of the Eagle Mountain SID was not an exercise of police power.



its opening brief and instead concludes that “there is no exercise of the police power until a municipality passes an ordinance and thereby ‘actually levies the assessment.’”

(Opposition Brief 31-32). First American has cited no authority, and indeed there is none, which supports the proposition that only an actual assessment, as opposed to an ordinance creating an improvement district, constitutes the exercise of governmental police power. It is axiomatic that the undertaking of actions by a municipality pursuant to statutory authority constitutes the exercise of governmental police power. *Rupp v. Grantsville City*, 610 P.2d 338, 340 (Utah 1980) (the actions of a municipality undertaken pursuant to express statutory authority, such as the creation of a municipal sewer system, constitute the valid exercise of the governmental police power); *Maple Leaf Investors, Inc. v. The Dept. of Ecology*, 565 P.2d 1162, 1166 (Wash. 1977) (same); *Winters v. Sawyer*, 463 S.W.2d 705, 707 (Tenn. 1971) (same); *West Frankfort v. Fullop*, 129 N.E.2d 682, 685 (Ill. 1955); *State v. Joseph*, 133 A. 352 (Vt. 1926) (same).

As First American correctly notes, the Utah Municipal Improvement District Act (“Act”) specifically provides for creation of special improvement districts within the state of Utah. See Utah Code Ann. § 17A-3-301 through § 17A-3-345. The Act further provides, and indeed mandates, recordation of the creation of a special improvement district in the public records. See Utah Code Ann. § 17A-3-307(6)(a)(i). Thus, the creation of the Eagle Mountain SID, as well as the Notice of Intention recorded incident to the Eagle Mountain SID, were undertaken by Eagle Mountain City pursuant to statutory authority and therefore constitute the exercise of governmental police power.

Because First American incorrectly concludes that only the levy of an actual assessment can constitute the exercise of police power, it fails to address the exception to the exclusion which provides coverage for the recorded notice of such exercise.

#### **IV. THE EAGLE MOUNTAIN SID AND THE NOTICE OF INTENTION CONSTITUTE AN “INCORRECTNESS” IN THE POLICIES**

First American argues that Vestin’s claim does not fall under the portion of the Policies that insures against an “incorrectness” in the representations contained in the Policies on the basis that there are no restrictions which cut off, subordinate or otherwise impair Vestin’s lien on the Property. (Opposition Brief 33). First American again ignores the plain meaning of the word “restriction” and summarily states that none exists. However, the existence of the Eagle Mountain SID and the recorded Notice of Intention subjected the Property to claims by a third party. Regardless of whether the actual amount of the claims against the Property by Eagle Mountain for the assessment had been determined, the Eagle Mountain SID and the Notice of Intention nonetheless harmed Vestin in restricting Vestin’s ability to use the property, e.g., sell the property without the adverse effect of the acceleration of the Assessment.

First American then reiterates its argument that because Vestin suffered no harm as a result of the Eagle Mountain SID or Notice of Intention, they could not have “impaired” Vestin’s mortgage on the Property. Rather than reading each word of the Policies in context and construing the plain meaning of the terms as required by the rules of contract construction, First American simply concludes that because no lien with priority over Vestin’s Trust Deeds existed, no restriction existed and Vestin’s mortgages

were not impaired. Rather than reading the word “impair” with its plain meaning, First American interprets it to mean being subordinated by another lien. The plain meaning of the terms in the provision does not support such a narrow reading.

The Policies provide coverage for any “[i]ncorrectness in the assurances which the Company hereby gives . . . [t]hat there are no covenants, conditions, or restrictions under which the lien of the mortgage can be cut off, subordinated, or otherwise impaired.” (R. 371). Therefore, a lien such as the Assessment Lien which existed on the property and which has priority over Vestin’s Trust Deeds would be covered. However, coverage is not limited only to the existence of perfected liens but is extended to anything which “impairs” Vestin’s liens. *Id.* The term “impair” is defined as “[t]o weaken, to make worse, to lessen in power, diminish, or relax, or otherwise affect in an injurious manner.” Blacks Law Dictionary 516 (6<sup>th</sup> ed. 1991); *see also Bel-Air Motel Corp. v. The Title Ins. Corp. of Penn.*, 444 A.2d 1119, 1123 (N.J. Sup. Ct. 1981), discussed *supra.* at 9-10.

The Eagle Mountain SID and the Notice of Intention, although they did not create a lien superior to or which subordinated Vestin’s mortgages, did “impair” Vestin’s title in that they affected Vestin’s title in a negative manner. As explained above, the Eagle Mountain SID and the Notice of Intention subjected Vestin’s Property to eventual assessments in excess of \$2 million. The fact that the exact amount of the assessments had not been determined does not change the fact that the failure to disclose the Eagle Mountain SID and the Notice of Intention constituted an “impairment” subjecting Vestin’s Property to the claims of Eagle Mountain for improvements. (R. 371). Because

First American's narrow reading of this provision is incorrect, this Court should reverse the decision of the district court and remand this case for further proceedings.

**V. THE EAGLE MOUNTAIN SID AND THE NOTICE OF INTENTION ARE "OTHER MATTERS" AFFECTING THE PRIORITY OF VESTIN'S TRUST DEEDS**

In arguing that the Eagle Mountain SID and the Notice of Intention do not constitute an "other matter" under the CLTA Form 104 Endorsements to Policies, First American again falls back on the erroneous position the term "lien" has the same definition as the term "other matter." Such an interpretation, however, ignores the plain meaning of the word "matter" and would render it meaningless and superfluous. "Matter" includes "facts material to [an] issue . . . event [or] occurrence." Blacks p. 675-76. In this case, the existence of the Eagle Mountain SID and the Notice of Intention, without question, constitute facts material to the Property. If Vestin had known about the Eagle Mountain SID, the impending assessment, and the acceleration of the assessment upon voluntary transfer, it could have restructured the sale of the Property, or chosen not to purchase the Property at all. Because the Notice of Intention would have had such a drastic effect on Vestin's actions, it was clearly a "matter" relevant to the Property subject to the Trust Deeds insured by the Policies.<sup>8</sup>

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<sup>8</sup> First American makes the argument that Vestin has no claim under on Policy No. 2701 on the grounds that it was issued before the Notice of Intention was filed. (Opposition Brief 8, 16 n.4, 18). However, as discussed in Appellant's Brief, the CLTA Form 104 Endorsements, which insure against "other matters" affecting title, are effective as of the date of issuance of the Endorsement. In this case, the Endorsements were issued after the date of the Policies and also after the Notice of Intention was filed. (Appellant's Brief 6-7). In this regard, in *Burke* § 3.03 at 3-51, it is stated:

## **VI. FIRST AMERICAN'S INTERPRETATION DOES NOT RENDER THE POLICIES UNAMBIGUOUS**

First American argues that the Policies are not ambiguous and that its interpretation of the Policies harmonizes the insuring clauses and the police power provision. (Opposition Brief, p. 35-38). First American contends that the “commonly accepted meanings” of the insuring provisions, as well as the police power provision, provide no coverage to Vestin. *Id.* The first flaw in this argument is that First American does not construe the terms in the Policies according to their “commonly accepted meanings,” as required by the basic rule of construction. Rather, as noted, First American has ignored the plain meaning of the insuring provisions in the Policies and has simply applied the meaning of the term to “lien” to the terms “defect,” “restriction,” “impair” and “other matter.” In addition, First American’s construction of the police power provision is based on the faulty premise that only the Assessment itself, not the creation of the Eagle Mountain SID and the Notice of Intention, constitutes the exercise of police power under the Policies. As with all the other provisions relied upon by Vestin, First American ignores the plain meaning of the police power provision and summarily concludes that it applies only to the actual Assessment Lien. Even accepting First American’s interpretation of the insuring clauses, the Policies would be rendered ambiguous because of the coverage afforded to Vestin under the police power provision.

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When, however, the insurer expressly consents to a general endorsement of a policy, the date of the endorsement controls the liability of the insurer. Defects in title falling within the scope of the endorsement and arising between the original date of the policy and the date of the endorsement are covered by the policy thereafter. The insurer has the duty to search the title for defects discoverable in the land records filed between those dates before issuing the endorsement.

First American argues that Vestin has impermissibly submitted the affidavits of Daniel Stubbs and Thomas Lea. This argument ignores Utah Rule of Civil Procedure 12(b) which specifically allows for the submission of matters outside the pleadings and conversion of a motion to dismiss into a motion for summary judgment. (Appellant Brief 14 n.3) In addition, Utah courts have specifically held that any relevant evidence may be considered in determining whether a contract is ambiguous and to determine the parties' intent. *See Ward v. Intermountain Farmers Assoc.*, 907 P.2d 264, 268 (Utah 1995). The affidavit of Daniel Stubbs establishes the harm suffered by Vestin as result of First American's failure to disclose the Eagle Mountain SID and the Notice of Intention, i.e., Vestin was prevented from restructuring the purchase of the property, or deciding not to purchase at all, to avoid the acceleration of the Assessment. It is inconsistent for First American to argue that Vestin has failed to show that it suffered any harm, and then argue that Vestin is not permitted to introduce evidence of that very harm. Finally, both the Lea and Stubbs affidavits show that it is both industry practice, and the practice of First American itself, to disclose in a title insurance policy if the insured property is located within a special improvement district. *See Somerset Saving Bank v. Chicago Title, Ins. Co.*, 649 N.E.2d 1123, 1127 (Mass. 1995) ("pertinent customs and usage are, by implication, incorporated into a policy and are admissible to aid in policy interpretation.".)<sup>9</sup> Both the Stubbs and Lea Affidavits were properly submitted by Vestin

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<sup>9</sup> First American argues in its footnote 15 that the affidavits submitted by Vestin "contain irrelevant and self-serving statements and legal conclusions," and makes the general objection that the affidavits lack proper foundation and reliability. In fact, the affidavits are relevant because they contain information that has "any tendency to make the existence of any fact that is

in opposing First American's motion to dismiss and, at the very least, raise ambiguities and issues of fact precluding summary disposition of this action.<sup>10</sup>

### **CONCLUSION**

Each portion of First American's argument is premised on the same incorrect assumption, i.e., that only recorded liens are covered under the Policies. Accepting First American's construction of the Policies would require this Court to ignore critical terms and provisions contained in the Policies. First American's interpretation would, in essence, be equivalent to stating that the terms "encumbrance," "defect," "restriction," "incorrectness," "impair," "other matter," and the insuring and police power provisions have one and only one meaning: a recorded lien. Such an interpretation, while convenient for First American, directly contradicts rules of contract interpretation and

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of consequence to the determination of the action more probable or less probable than it would without the evidence." Utah R. Evid. 401. In this case, for example, the affidavits set forth the matters discussed in the foregoing text. Furthermore, the general objection made by First American does not preserve the objection for review. *See* Utah R. Evid. 103(a)(1). As to the claim of self-serving, affidavits are obviously submitted by a party in support of its position. As long as the affidavit complies with evidentiary rules, it is admissible.

<sup>10</sup> In footnote 15 of the Opposition Brief, First American argues that Vestin attempts to convert the Motion to Dismiss into a motion for summary judgment by submitting affidavits. First American argues that Utah Rule of Judicial Administration 4-501(2)(B), now Utah Rule of Civil Procedure 7, requires that an opposition to a motion for summary judgment must contain a verbatim restatement of the movant's facts which the party contends an issue of fact exists, and that Vestin failed to do so. First American concludes that therefore the request that the matter be treated as a motion for summary judgment be disregarded. When materials outside the pleadings are filed in response to a motion to dismiss, it is within the Court's discretion to consider such matters. *See* Utah R. Civ. P. 12(b). Only if the court does not exclude the submitted materials is the motion treated as one for summary judgment, and then "all parties shall be given reasonable opportunity to present material made pertinent to such a motion by Rule 56." Not until the Court considers the material does the motion convert to a motion for summary judgment. As a result, there was no requirement that Vestin comply with Rule 4-501 until after the Court first determines to consider materials outside of the pleadings and converts the motion to one for summary judgment. Accordingly, Vestin did not fail to comply with Rule 4-501.

would nullify the insuring provisions of the Policies, as well as the exception to the exclusion which confirms coverage in this instance.

A simple reading of the plain and ordinary terms of the Policies demonstrates that the Eagle Mountain SID and the Notice of Intention, while not an existing lien, even so still fall within the meaning of the terms “defect,” “restriction” and “other matter” in the Policies. Further, the only interpretation of the police power provision which comports with well-established case law is one that confirms that the recorded Notice of Intention falls within the exception to the exclusion for the exercise of police power.

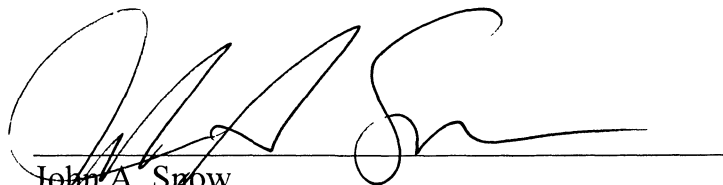
Vestin’s interpretation of the Policies comports with well-established rules of contract interpretation and harmonizes all provisions of the Policy to provide coverage to Vestin. At a minimum, the police power provision, which unequivocally provides coverage for Vestin’s claims, creates an ambiguity in the Policies.

The district court erred in dismissing Vestin’s Complaint and this case should accordingly be reversed and remanded for further proceedings.

DATED this 21st day of June, 2004.

VAN COTT, BAGLEY, CORNWALL & McCARTHY

By:

A handwritten signature in black ink, appearing to be 'John A. Snow', written over a horizontal line.

John A. Snow

Stephen K. Christiansen

Cassie Wray

*Attorneys for Appellant*



**CERTIFICATE OF SERVICE**

I hereby certify that I caused two (2) true and correct copies of the within and foregoing **REPLY BRIEF OF APPELLANT** to be mailed, postage prepaid, this 21<sup>st</sup> day of June, 2004, to the following counsel of record:

Alan L. Sullivan  
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