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Insurance and the Mortgagee*

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The legal position of a mortgagee under a policy of fire insurance is generally considered to have been fairly well settled in the decided cases, whether the policy be one with a mere designation of the mortgagee as payee or, as is more usual, one to which in addition the customary mortgage clause has been attached. In either case the assumption is that the mortgagee is given adequate protection of his interest in the insured property. It is the purpose of this paper to re-examine the decisions and to ascertain whether in fact reliance can be placed on the assumption.

Consider first the mortgagee's position where no separate mortgage clause is attached to the policy. In such a case the policy is either an insurance of the property by the mortgagor as owner (with or without the loss being made payable to the mortgagee) or an insurance by the mortgagee of his own interest at his own expense. The latter type of policy is rare nowadays, but, since the policy is one of indemnity, on a loss occurring the insurance company would be subrogated to the rights of the mortgagee. That subrogation arises in such circumstances was made clear as long ago as 1900 in *Goldie* v. *Bank of Hamilton.*[1] Where, however, the insurance is taken out by the mortgagor as owner and paid for by him (or in any event is chargeable to him under his covenant to insure in the mortgage), the mortgagee is usually named as payee, and if he is he has no higher rights under the policy than the mortgagor. This was held in

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[1] 27 O.A.R. 619.

McKay v. *Norwich Union*,[2] and is still the law, although the case was not followed in the recent decision of the Ontario Court of Appeal in *Farmers Mutual* v. *Hanrahan*.[3]

Where a separate mortgage clause is attached to the policy the mortgagee's position has been held to be entirely different from that of the mortgagor (except in the unusual case where the policy itself is void *ab initio*, as, for example, where it has been obtained by misrepresentation; in that case the mortgagee again stands in the same position as the mortgagor).[4] Loan companies and other mortgagees frequently use special forms of their own, but the one in most general use is that adopted by the Canadian Underwriters' Association, which reads as follows:

> It is hereby provided and agreed that this insurance, as to the interest of the Mortgagees only therein, shall not be invalidated by any act or neglect of the Mortgagor or owner of the property insured, nor by the occupation of the premises for purposes more hazardous than are permitted by this policy.
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> It is further provided and agreed that the Mortgagees shall at once notify said Company of non-occupation or vacancy for over thirty days, or of any change of ownership or increased hazard that shall come to their knowledge; and that every increase of hazard, not permitted by the policy to the Mortgagor or owner, shall be paid by the Mortgagees on reasonable demand from the date such hazard existed, according to the established scale of Rates for the use of such increased hazard during the continuance of this insurance.
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> It is also further provided and agreed that whenever the Company shall pay the Mortgagees any sum for loss under this policy, and shall claim that, as to the Mortgagor or owner no liability therefor existed, it shall at once be legally subrogated to all rights of the Mortgagees under all the securities held as collateral to the Mortgage debt, to the extent of such payments, or, at its option, the Company may pay to the Mortgagees the whole principal due or to grow due on the Mortgage, with interest, and shall thereupon receive full assignment and transfer of the Mortgage, and all other securities held as collateral to the Mortgage debt, but no such subrogation shall impair the rights of the Mortgagees to recover the full amount of their claim.
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> It is also further provided and agreed that in the event of the said property being further insured with this or any other Office, on behalf

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[2] (1896), 27 O.R. 251.

[3] *Farmers Union Mutual Fire Insurance Co.* v. *Hanrahan*, [1941] O.R. 163. Here the decision turned on another point arising from a decision of the Supreme Court of Canada in *Imperial Fire Insurance Co.* v. *Bull* (1889), 18 S.C.R. 697, Cameron's S.C. Cases 1 (*Sub nom.*, *The Imperial Fire Insurance Co.* v. *Bull & North British Investment Co.*).

[4] *Liverpool & London & Globe Insurance Co.* v. *Agricultural Savings & Loan Co.* (1903), 33 S.C.R. 94. It had previously been held in *Omnium Securities Co.* v. *Canada Fire and Mutual Insurance Company* (1882), 1 O.R. 494, that the terms of the mortgage clause protected the mortgagee only against acts of the mortgagor committed after the issue of the policy.

> of the owner or Mortgagees, the Company, except such other insurance when made by the Mortgagor or owner shall prove invalid, shall only be liable for a rateable proportion of any loss or damage sustained.
>
> At the request of the Insured, the loss, if any, under this Policy, is hereby made payable to as interest may appear, subject to the conditions of the above '*Mortgage Clause*'.
>
> Dated at this day of 19 .
>
> Attached to and forming part of Policy No.

The clause commences by saying "It is hereby provided and agreed", but it does not say by and between whom. Similarly, it provides that the insurance, as to the interest of the mortgagees only, shall be subject to certain conditions, but again there is no specific agreement to this by the mortagees. In other words, notwithstanding the attachment of the mortgage clause and the statement in the clause itself that it is attached to and forms part of the policy, the contract appears only to be between the mortgagor and the company, although it is primarily and obviously intended to give special protection to the mortgagee in the event of loss. It is reasonable, then, to ask whether the mortgage clause is effective in conferring this protection on the mortgagee or whether, in fact, the effect of the clause is merely to create an agreement by the assured, the mortgagor, with the insurer that in the event of loss the insurer will pay the mortgagee according to the terms of the mortgage clause, if the mortgagor is entitled to collect under the policy. If the latter is the case, it is difficult to see how the mortgage clause gives the mortgagee any independent right to collect on his own behalf, even though the mortgage clause purports to impose upon him certain obligations as well as to confer upon him certain enforceable rights.

That the supposed obligations of the mortgagee are a very important feature of the clause will be seen from the first part of the second sentence:

> It is further provided and agreed that the Mortgagees shall at once notify said Company of non-occupation or vacancy for over thirty days, or of any change of ownership or increased hazard that shall come to their knowledge.

The policy, however, is not executed in any way by the mortgagee and again there seems to be no covenant although he has in his possession a policy to which a mortgage clause, so phrased, is attached. Nevertheless, it has been held that the just quoted phrase *is* a covenant and that the insurance company's only remedy for failure by the mortgagee in this regard is the recovery

of damages for breach of covenant.[5] The contention of the defendant in that case was that the liability of the insurer to the mortgagee was conditional upon the mortgagee having notified the insurer of the change of ownership, of which he was aware, and that since admittedly this had not been done there was no right of recovery. The court declined to accept this argument and held, as we have seen, that the only penalty for such failure would be a claim for damages for breach of what was held to be a covenant.

The real effect of this decision is, however, much wider than would appear at first glance. At the inception of any risk the company has, of course, the option of accepting or rejecting it. Assuming the mortgagor to be the applicant, the policy issued to him will contain the statutory conditions and in the event, as in this case, of a change of ownership the company would not be liable (statutory condition 7) unless notified of the change by the mortgagor. Furthermore there would be no liability on the insurance company in such a case (since there is an assignment of interest) unless permission is given by the policy or endorsed thereon (statutory condition 5). Obviously permission could only be given when notice is received. Thus there is a definite penalty for failure to notify the company of the change as far as the mortgagor is concerned, but no penalty is in fact placed on the mortgagee under the decision since the company's only remedy for failure of the mortgagee to notify of a change of ownership has been held to be damages for breach of the covenant to notify, and it is impossible to visualize any case where a mere change of ownership, although vital from an underwriter's standpoint, would be considered by the court to have any effect on the actual occurrence of a fire or the amount of the loss ensuing from it. Hence the mortgagee may with impunity commit a breach of his covenant, while at the same time the company is bound by its covenant and must pay the loss. It is, perhaps, not too much to expect that the insurance company's covenant to pay should be treated as conditional upon the observance by the mortgagee of his covenant to notify.

From an insurer's point of view, the *London Loan* case impinges still further upon the insurer's right to accept or refuse any particular risk since, if the company were notified of a change of ownership, it would have the right to elect whether it would continue the insurance or cancel. Consequently, when no notice

[5] *London Loan & Savings Co. of Canada* v. *Union Insurance Co. of Canton imited* (1925), 56 O.L.R. 590; affirmed, 57 O.L.R. 651.

is given the company is deprived of this right of election and unknowingly continues on a risk that it would perhaps have refused to carry.

The other purported obligations of the mortgagee in the second sentence of the mortgage clause fall into the same principles as now established by the *London Loan* case. In the end, therefore, one would have to come back to the questions whether the mortgagee on his part has agreed to do anything and whether the company has given him any rights by the attachment of the clause to the policy.

The third sentence of the mortgage clause purports to subrogate the insurer, in the event of his disputing liability to the mortgagor, to the position of the mortgagee on payment to the mortgagee of his interest in the property insured, if the loss equals or exceeds that interest, and, if it does not, on payment to the mortgagee of any balance of his claim over and above such loss. Apart from this clause there would be no subrogation, since subrogation can only arise under a contract of indemnity and, upon a loss occurring, arises automatically.[6] Clearly, of course, the contract with the mortgagor is one of indemnity, but if the company is entitled to subrogation to the rights of the mortgagee it can only be because the mortgage clause itself constitutes a separate contract of indemnity between these two parties. Furthermore, if the clause in itself is a contract of indemnity, then the inclusion of a subrogation clause adds nothing to the rights of the parties and can be considered redundant.

By the terms of the mortgage clause subrogation is to arise as soon as the insurer claims that no liability exists towards the mortgagor or owner. There is no requirement in the clause that the insurer's claim of exemption from liability must be established before the right to subrogation arises, although a case in the Supreme Court of Canada has been cited, and indeed at one time followed, as authority for such a proposition.

On this point reference might be made to the writer's article, Fire Insurance, in 6 Canadian Encyclopaedic Digest[7] where it is stated:

> It has been thought to have been held that the insurer is not subrogated to the rights of the mortgagee, unless he first establishes in an action a good defence against the mortgagor, but this is not so.[q]

Note (q) referred to in this quotation is as follows:

[6] *Castellain* v. *Preston* (1883), 11 Q.B.D. 380; 52 L.J.Q.B. 366; followed in *Guardian Assurance* v. *Chicoutimi* (1915), 51 S.C.R. 562; and see the discussion of the *Castellain* case in 6 Canadian Encyclopaedic Digest at p. 214.

[7] (1928), Sec. 106, p. 217.

(q) *Bull* v. *North British Invest. Co. Ltd. and Imperial Fire Insur. Co.* (1888), 15 O.A.R. 421, affirmed 18 S.C.R. 697. See Cameron's Supreme Court Cases, p. 1, where the statement is made by the registrar of the court that the decision is incorrectly reported in 18 S.C.R. 697. The decision in the *Bull Case*, as reported in 18 S.C.R. 697, is that the insurance company, before becoming entitled to subrogation, must first establish by action that it was under no liability to the assured; but the report in Cameron's Supreme Court Cases corrects this as only two judges out of the four comprising the court concurred in so holding, and so it is not a binding decision on this point, however valuable as a weighty expression of opinion. The report of the *Bull Case* in 18 S.C.R. 697 has been followed in Ontario as binding in a case of *McKay* v. *Norwich Union Insur. Co.* (1895), 27 O.R. 251.

The view expressed in these quotations has recently been accepted by the Ontario Court of Appeal in *Farmers Mutual* v. *Hanrahan* where Mr. Justice McTague deals with the point in almost identical words:[8]

> In *Bull* v. *The North British Canadian Investment Company and The Imperial Fire Insurance Co.* (1888), 15 O.A.R., the general principle was laid down that the right of an insurance company to be subrogated to the mortgage rights of the mortgagee in the case of a policy of insurance containing the usual subrogation clause depends upon whether it has a good defence against the claim of the mortgagor, who as between himself and the insurance company is the party insured. On appeal to the Supreme Court of Canada two of the Judges in a Court of four appear to have placed the obligation of the insurance company higher by holding that before it becomes entitled to subrogation it must first establish by action that it was under no liability to the assured. This holding was erroneously reported as the decision of the Court in 18 S.C.R. 697. As is pointed out in Cameron's Supreme Court Cases, p. 1, the real decision was simply an affirmation of what had been held in the Ontario Court of Appeal. Whatever weight may be given the opinions of the two Judges who concurred in setting forth the view incorrectly reported as the decision of the Court, the fact remains that it was not the Court's decision and is therefore not binding, although it was subsequently treated as binding in *McKay* v. *Norwich Union Insurance Company* (1896), 27 O.R. 251.
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> In my view, the correct principle is still to be found in the judgment of the Court of Appeal in the *Bull* case. Accepting the principle therein laid down as applied to the facts of the case at bar, dealt with by my brother Middleton, the insurance company was entitled to the assignment of the mortgage in question and is entitled to its judgment for foreclosure.

In the *Hanrahan* case the court allowed the claim of the insurer to be subrogated to the mortgagee's rights in view of its plea that it had a good defence under the policy to any claim by the mortgagor; two of the three judges thought that the insurer's

[8] [1941] O.R. 163, at p. 166.

contention was justified. In that case the mortgagee was not claiming against the insurer but the insurer was attempting to enforce against the mortgagor the mortgagee's rights under the mortgage itself on the ground of subrogation by virtue of the mortgage clause, since the insured had paid the loss to the mortgagee. It was not necessary, therefore, for the court to deal with the question whether the insurer had a valid defence to any claim of the mortgagor because the court had already held that the insurer was subrogated to the mortgagee's rights, which disposed of the issue between the parties. Nevertheless Mr. Justice Middleton, with whom Mr. Justice Fisher agreed, went on to say that the insurance company had a good defence against the mortgagor in that he, the mortgagor, had not pleaded that he had delivered proofs of loss as required by the statutory conditions and that, moreover, he had failed to make any claim against the company until instituting his counterclaim in the action brought by the company to enforce the mortgage against him.

Lastly, the fourth sentence of the clause, providing for contribution in the event of other insurance, covers not only any other insurance by the mortgagor but also any further insurance effected by the mortgagee. This is no doubt an attempt to bring into contribution any insurance the mortgagee may place himself for his own protection, which otherwise would not contribute under statutory condition 8(c), the general provision for contribution;[9] but statutory condition 8 would not apply in such a case since it has been held that the interest of the mortgagee is a separate interest from that of the mortgagor and that there can be no contribution, therefore, since there is no duplication of insurance of the same interest.[10]

The mortgagee has, too, certain statutory rights in addition to those purported to have been given to him by the mortgage clause. The Insurance Act provides[11] that where a policy is payable to a mortgagee, and cancellation would be prejudicial to his interest, the policy cannot be cancelled without notice to him and, under the Mortgages Act,[12] the mortgagee has a right to be paid the proceeds of any fire policy effected by the mort-

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[9] Statutory condition 8(c) is as follows:
"In the event of there being any other insurance on property herein described at the time of the happening of a loss in respect thereof, the insurer shall be liable only for payment of a rateable proportion of the loss or a rateable proportion of such amounts as the insured shall be entitled to recover under clause (a) of this condition."

[10] *Clarke* v. *Fidelity-Phoenix Fire Insurance Co.* (1926), 58 O.L.R. 148.

[11] R.S.O., 1937, c. 256, s. 106, Statutory Condition 9.

[12] R.S.O., 1937, c. 155, s. 5.

gagor. This latter statutory right was recognized and enforced in *Scott* v. *Crinnian*.[13]

The practical value of such rights depends solely, of course, upon whether or not the insured has a claim for the loss which he could enforce against the insurer; if he has, the money recovered must, in Ontario at least, be paid to the mortgagee even if he is not named in the policy.[14]

It has been held too that the mortgagee's claim takes precedence over a garnishee or attaching order obtained after the amount of a fire loss has been adjusted and the company has agreed to pay it;[15] in any event no attaching order could be made until the loss by fire has been agreed to be paid because there is until then no debt to be attached.[16]

Frequently where there is more than one mortgage on a property the insurance policy is made payable to the first mortgagee and then to the second as their interests may appear, in which case, in the event of a loss, the full amount of the insurance money may be applied in satisfaction of the claim of the first mortgagee and the property, to the extent to which it is freed from the mortgage debt, is then available to the execution creditors and the second mortgagee has no right to complain.[17]

No study of the legal position of the mortgagee under a fire policy would be complete without referring to some, at least, of the many variations from the standard mortgage clause that have been introduced by corporate mortgagees. In one specimen examined it is provided that, ". . . notwithstanding anything contained in, or omitted from, the application or proposal for insurance", the insurance shall remain in full force. This provision is an attempt to avoid the danger to the mortgagee consequent upon the decisions in *Omnium Securities Co.* v. *Canada Fire & Mutual Insurance Co.*[18] and *Liverpool and London and Globe Insurance Co.* v. *Agricultural Savings & Loan Co.*,[19] where it was held that the mortgage clause was of no effect if the insurance policy

[13] (1918), 43 O.L.R. 430.
[14] The Mortgages Act (*supra*).
[15] Cf. 6 C.E.D., p. 218, Note (x), as follows:
"Unreported decision of Charles Garrow, K.C., Master of the Supreme Court of Ontario in *Hay* v. *Royal Exchange* (1927) following *Greet* v. *Citizens Insur., supra*, citing Falconbridge on Mortgages, p. 719, Cyc., Vol. 19, p. 885 and Halsbury, Vol. 4, par. 803 as additional authorities."
Cited in *Re Alliance Insurance Co. et al.*, [1946] O.R. 298, at p. 303.
[16] *Simpson* v. *Chase* (1891), 14 P.R. 280; cited and followed in *Re Alliance Insurance Co. et al.* (*supra*).
[17] *Midland Loan & Savings Co.* v. *Genitti* (1916), 36 O.L.R. 163.
[18] (1882), 1 O.R. 494.
[19] (1903), 33 S.C.R. 94. On this point see footnote 4 *supra*.

itself was void *ab initio* by reason of misrepresentation and that the mortgage clause only applies to subsequent acts of the mortgagor. The effectiveness of the just quoted variation would, in any case, be restricted to invalidity arising from statements contained in, or omitted from, the application or proposal for insurance.

This same specimen also makes provision for proof of loss by the mortgagee himself. This provision may, however, be open to question, since, in the first place, statutory condition 14[20] requires that proof of loss *must be made by the insured*, or, in certain cases, by his agent (even though the loss be payable to a third person) and that only in certain specified cases can proof of loss be made by the payee himself, and, secondly, section 106 of the Insurance Act prohibits omissions from or additions to the statutory conditions. The completing of proofs of loss by the mortgagee is, however, not necessarily impossible in view of statutory condition 15, which requires that any person entitled to claim under the policy shall complete proofs of loss and the mortgagee may be such a person. Furthermore, the mortgagee as a "person entitled as beneficiary or by assignment or other derivative title to the insurance money" may, under section 95(2) of the Insurance Act, be entitled to sue in his own name for the insurance money, "any rule, stipulation or condition to the contrary notwithstanding". Thus, perhaps, the question of the right or duty of the mortgagee to make proof of loss may, in effect, be immaterial. It should be remembered, however, that such right of direct action is limited by section 95 to a beneficiary or assignee who "has the right to receive the same [the insurance money] and to give an effectual discharge therefor", and there are many cases where, it would seem, the mortgagee could not give such a discharge, as, for instance, where the amount of the insurance money payable exceeds the interest of the mortgagee in the property, and any such excess thereupon becomes available to subsequent payees or to the owner himself.

In the same specimen appears the unusual provision that:

> . . . this policy as between the Company and the mortgagee shall continue in force so long as any of the money secured by the mortgage is unpaid.

This clause would formerly have been contrary to the provisions of the Insurance Act limiting the term of a fire policy to one year for mercantile risks and three years for other risks, but this

[20] R.S.O., 1937, c. 256, s. 106.

limitation has been removed by statutory amendment[21] and the clause is, therefore, unobjectionable as the law now stands.

Many of the specimen clauses provide for non-cancellation or for cancellation only on notice to the mortgagee (and in some cases to the second mortgagee as well), but this requirement would seem unnecessary since, as we have seen, statutory condition 9[22] itself requires reasonable notice to be given to persons to whom the loss has been made payable. Other specimens provide that in the event of cancellation a pro rata portion of the insurance premium must be returned to the mortgagee, although, of course, the premium is actually paid by the mortgagor, or charged to him. Such a clause may be an addition to statutory condition 10, which provides for the refunding of paid premiums to the insurer (presumably the mortgagor) and may, therefore, be of no effect.

Another clause qualifies the usual obligation of the mortgagee to notify the company of change of ownership and the like by adding that failure "to give any notice required under this policy" shall not invalidate the policy — a provision that would be redundant if my analysis of the *London Loan* case is correct.

Another clause provides that:

> . . . this insurance has not in any way or manner been invalidated and is now in full force and effect as to the interest therein of the mortgagees.

This provision, a direct assurance to the mortgagee of the present validity of the policy, is intended to protect him against initial invalidity.

The specimen from which this clause is taken also contains this unique clause:

> . . . that this mortgage clause is attached to and forms part of the above policy of insurance and all conditions or anything contained in, endorsed upon, or attached to the said policy, inconsistent herewith shall be and the same are hereby waived and cancelled as between the mortgagee and the company.

This purported protection of the mortgagee would, of course, have to be in conformity with statutory condition 22, which requires that any such waiver, to be effective, must be signed by an agent of the insurer. Another point might well arise if it were argued, in any individual case, that the inconsistency was with a statutory condition; as already noted, section 106 prohibits any

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[21] Statutes of Ontario (1939), 3 Geo. VI, c. 22, s. 1 (proclaimed March 1st, 1941).

[22] R.S.O., 1937, c. 256, s. 106.

omission from or addition to the statutory conditions while, with an apparent inconsistency, statutory condition 22 appears to contemplate a permissible waiver of the conditions. This difficulty, so far as the writer is aware, has not been considered by any of our courts and remains, therefore, unresolved.

The most important variation in any of the specimens is one in which it is stated that the mortgagee and the insurance company agree, for a named consideration, to the terms of the mortgage clause. This, clearly, is an attempt to make a separate contract between the mortgagee and the insurance company, and may indeed have that effect since the mortgagee furnishes the special form to the insurance company and the latter issues the policy with the clause attached, thereby, through performance, completing the contract without the usual notification of acceptance of the risk.[23]

This brings us to the problem mentioned earlier in the paper, namely, how a policy, issued to a mortgagor with a mortgage clause attached, can in law create individual and separate contractual rights between the company and the mortgagee.

In Alberta, as early as 1916, Beck J. held in *Laidlaw* v. *Hartford Fire*[24] that the mortgagee could sue the company on a policy to which there had been attached the usual mortgage clause, on the following alternative grounds:

(a) that the existing contract was a tripartite one to which he was a party; or
(b) that he is the principal and the assured his agent; or
(c) that he is the *cestui que trust* of the assured.

This case has been followed in Alberta on two occasions[25] and was cited by Middleton J. A. in the *London Loan* case[26] where, in giving the judgment of the court, he decided the point in favour of the mortgagee because such a conclusion

(a) had been reached earlier by the Ontario Court of Appeal in the *Agricultural Savings & Loan* case;[27] and
(b) was supported by certain American cases and text books, and by the leading English text on the subject, Welford & Otter-Barry on Fire Insurance.[28]

In considering the effect of the Court of Appeal judgment in

[23] See *British Traders Insurance Co.* v. *Queen Insurance Co.*, [1928] S.C.R. 9, citing, at p. 12, *Carlill* v. *Carbolic Smoke Ball Co.* (1893), 1 Q.B. 256.
[24] (1916), 10 A.L.R. 7; 34 W.L.R. 993; 29 D.L.R. 229.
[25] *Re McMillan*, [1929] 3 W.W.R. 202; [1929] 4 D.L.R. 640, and *Stephens* v. *Perdue*, [1931] 3 W.W.R. 90; [1931] 4 D.L.R. 46.
[26] *Supra.*
[27] (1902), 3 O.L.R. 127.
[28] 2nd ed., p. 48; cf. 4th ed., 1948, pp. 42 *et seq.*

the *Agricultural Savings & Loan* case, it should be stated at the outset that the report contained two decisions, one against the *Liverpool and London and Globe Insurance Co.* in respect of a policy containing a mortgage clause and one against the *Alliance Insurance Co.* where there was no mortgage clause. In both policies, however, the mortgagee was the named payee. In the *Liverpool & London & Globe* case, Armour C.J.O. held the mortgagee to be a party to the policy, the policy being, not a deed *inter partes* (as to which he conceded the position might be different), but a deed poll. Apart from the fact that such a policy is not distinguishable from a deed *inter partes*, that learned judge would himself not appear to have been entirely satisfied with this ground for he added immediately afterwards:

> And if anything were wanting to shew that the plaintiffs were parties to this policy it is supplied by the mortgage clause to which the policy is made subject, which contains express agreements between the plaintiffs and the defendant company.

As already remarked, it is doubtful from the wording of the mortgage clause itself whether there is in fact an express agreement.

In the *Alliance* case, however, the Chief Justice held that the mortgagee's right to sue under the policy arose by reason of an equitable lien emanating from the covenant to insure in the mortgage. Middleton J. A., however, in the *London Loan* case, when adopting Chief Justice Armour's view as to the mortgagee being a party, also stated that the Chief Justice had based his decision on the existence of an equitable lien arising from the fact that by the policy the loss was payable to the mortgagee, when in fact, as noted above, the Chief Justice had placed it on the ground of the covenant to insure contained in the mortgage itself. Moreover, the Chief Justice's statement was not made in the *Liverpool & London & Globe* case, as intimated by Middleton J.A., but in the *Alliance* case,[29] where there was no mortgage clause; yet, even if there were a lien, it would seem that the mortgagee's rights would be subject to all the defences available against the named insured, the mortgagor, the very result that is intended to be avoided by the use of the separate mortgage clause.

The position under the American authorities is stated by Middleton J.A. as follows:[30]

> These cases almost uniformly uphold the mortgagee's right to sue, sometimes upon the ground that the provision in the contract is a contin-

[29] (1902), 3 O.L.R. at p. 140.
[30] (1925), 57 O.L.R. at p. 654.

> gent order or assignment of the money should the event happen upon which the insurance money becomes payable; sometimes upon the ground that there is an independent and derivative contract between the insurance company and the mortgagee; sometimes because the insurance when effected by the mortgagor is in truth effected by him as agent for the mortgagee; sometimes because the mortgagor makes the insurance in pursuance of a covenant obliging him to insure for the protection of the mortgagee, and so he holds the policy in some fiduciary capacity for the mortgagee, and the mortgagee may, therefore, assert his right by an action, making the mortgagor a party defendant where this is necessary for the protection of the insurance company.

Before discussing these grounds in detail, reference should be made to Middleton J. A.'s only other ground for giving the mortgagee a direct right of action against the insurer. For this he cited English authorities, both cases and texts, as follows:[31]

> Welford & Otter-Barry on Fire Insurance, 2nd ed., p. 48 *et seq.*, after shewing that it is competent for the mortgagor to insure his own interest, state that it is equally competent for any person having an insurable interest in the subject-matter to effect insurance which will cover not only his own interest but the interest of all those others, and they illustrate this by the cases of insurance effected by warehousemen and carriers, in reality for the protection of those owning the goods entrusted to the insurer [*sic*], and make this equally applicable to the case of mortgagor and mortgagee. They refer to the case of *Martineau* v. *Kitching* (1872), L.R. 7 Q.B. 436, particularly referring to what is there stated by Blackburn J., at p. 458; see also *Waters* v. *Monarch Life Assurance Co.* (1856), 5 E. & B. 870; *Ebsworth* v. *Alliance Marine Insurance Co.* (1873), L.R. 8 C.P. 596; and the Nova Scotia case *Seaman* v. *West* (1884), 17 N.S.R 207.

Although it cannot be disputed that anyone having an insurable interest may insure for the benefit of others also having insurable interests, our courts have held that this depends on the intention of the person effecting the insurance[32] and, it would seem, must be based upon agency express or implied, as is always the case in the instances cited of warehousemen and carriers. The relationship of agency, however, does not necessarily arise between mortgagor and mortgagee. In the usual case the mortgagor's policy insures primarily his own interest, with a named payee, and leaves the interest of the mortgagee to be covered by the attachment of a mortgage clause. Moreover, it is difficult to construe a covenant by the mortgagor to insure the property as implying an authority or obligation to effect insurance, as agent, of the separate interest of the mortgagee.

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[31] *Ibid.*, at p. 654.

[32] For a summary of the authorities on this point, see 6 C.E.D., Sec 103, p. 210, footnote (d).

On this point, the British Columbia Court of Appeal in *National Fire Insurance Co. of Hartford* v. *Emerson*[33] unanimously reached a conclusion contrary to that of Middleton J.A. In that case the court held that the mortgagor was insuring only for himself, and that no privity of contract could be established between the company and the mortgagee on the basis of the mortgagor being the mortgagee's agent. In giving judgment, McPhillips J.A. said:

> I do not consider there was any privity of contract. Viscount Haldane, L.C. in the case of *Grand Trunk Railway Company of Canada* v. *Robinson*, [1915] A.C. 740 at 747, says in very terse language, on the question of agency: 'Such agency will be held to have been established when he is shewn to have authorized antecedently, or by way of ratification, the making of the contract under circumstances in which he must be taken to have left everything to his agent.' If it had been that Windsor [the mortgagor] was Emerson's agent to go out and place insurance, and, being that agent, obtained a policy containing a clause such as we have before us, and that when Emerson was handed that policy he put it in his safe, without reading it, then I think he would be indebted to the Company. There was no such agency, and there was no privity of contract, because privity of contract would have to be established through agency.

This case, incidentally, shows that the insurance company, as well as the mortgagee, may have an interest in establishing a separate contract between itself and the mortgagee since there the company, on the basis of such a contract, was claiming payment by the mortgagee of the premium earned on the policy up to the date of cancellation.

According to Middleton J.A., the American authorities have maintained the existence of a separate contract between the mortgagee and the insurance company on the following grounds:

(1) That "the provision in the contract is a contingent order or assignment of the money should the event happen upon which the insurance money becomes payable". It is clear that the position of an assignee, even assuming that the mortgagee is such where there is no covenant in the mortgage to assign the policy, as was the case in *Agricultural Savings & Loan* v. *Alliance*,[34] is no higher than that of the assignor. This is conceded without exception in the American cases I have examined, but only, it should be noted, in cases of ordinary loss-payable clauses (as was the policy, and the decision, in the *Agricultural Savings & Loan* v. *Alliance* case) and not in those cases upon policies to which the "union" or "standard" mortgage clause had been

[33] (1915), 22 B.C.R. 349.
[34] (1902), 3 O.L.R. 127; aff'd 33 S.C.R. 94.

attached. In these latter it has been specifically held that the mortgagee has a separate contract and is not therefore, as is an assignee, subject to the defences available against the mortgagor.

(2) That "there is an independent and derivative contract between the insurance company and the mortgagee". This, it would seem, is rather a conclusion of law than a statement of the legal grounds upon which such a conclusion may be based, and so affords little or no assistance in resolving the problem with which we are here concerned.

(3) That "the insurance when effected by the mortgagor is, in truth, effected by him as agent for the mortgagee". This argument of an agency relationship was, as we have seen, convincingly rejected by the British Columbia Court of Appeal in *National Fire Insurance Co. of Hartford* v. *Emerson*.[35]

(4) That "because the mortgagor makes the insurance in pursuance of a covenant obliging him to insure for the protection of the mortgagee, and so he holds the policy in some fiduciary capacity for the mortgagee, and the mortgagee may, therefore, assert his right by an action, making the mortgagor a party defendant where this is necessary for the protection of the insurance company". According to Chitty on Contracts:[36]

> It was clearly settled at common law, that a mere stranger to the consideration could not enforce performance of the contract by an action thereon in his own name, although he were the party avowedly intended to be benefitted thereby . . . [yet] where one of the parties to an agreement is in fact the nominee or trustee of a third person and makes the agreement in that capacity, the *cestui que trust* can take the benefit of the contract.

Can the position of the mortgagee, where there is a mortgage clause, be treated with justification as giving rise to such a trust relationship, thereby bringing him, the mortgagee, within the stated exception to the well-settled rule that strangers to the consideration in a contract acquire no rights as against the contracting parties? A recent American pronouncement is strongly in favour of a negative answer:[37]

> . . . the general rule is that the relation between the parties to an executed contract of insurance is that of one contracting party to another contracting party rather than that of trustee and cestui que trust.

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[35] (1915), 22 B.C.R. 349.

[36] 19th ed., 1937, pp. 39. *et seq.*

[37] *Moore* v. *Pilot Insurance Co.* (1936), 86 F. (2d) 197, at p. 199: citing a number of American authorities and the Ontario case of *Potts* v. *Temperance Life* (1892), 23 O.R. 73.

Moreover, in none of the cases has any attempt been made to formulate a legal justification for a trust relationship in such circumstances. One would concede that, should the mortgagor become possessed of the proceeds of a loss, he might well be held to be a trustee thereof for the mortgagee; but this result would arise in any event from the relationship created by the mortgage itself or from the provisions of the Mortgages Act[38] and not, it would seem, from any trust relationship arising from or under the policy. Indeed, it is difficult to see how the attachment of a mortgage clause to a policy could be interpreted as creating a trust or as an undertaking by an insurance company to act as a trustee when, in fact, the clause purports to be — and is consistently considered to be — founded in contract. Then, too, it is clear that in order to create a trust there must be a settlor, a trustee, a *cestui que trust* and a subject matter; it is, it is submitted, a straining of the language to assign these attributes to the relationship created between a mortgagor, mortgagee and insurance company under a policy of fire insurance. In any event, the subject matter, *i.e.*, the proceeds of any loss by fire, is, at the time of the issue of the policy, nothing more at best than a bare possibility. In short, in the absence of any clearly defined judicial basis for the establishment of a trust relationship in such circumstances, one would perhaps be justified in doubting whether this last ground mentioned by Middleton J.A. is a sound one.

So far, too, as concerns the learned judge's suggestion that any doubt as to the existence of a contractual relationship might be met by the addition of the mortgagor as a party in the mortgagee's action, it is perhaps sufficient to say that, apart altogether from the obvious difficulty where the mortgagor has disappeared or become otherwise unavailable, the addition of the mortgagor would not in any way strengthen the mortgagee's claim but would only enable the court to dispose of the mortgagor's rights, which might well be of no moment. If, of course, the mortgagee were suing as assignee it might be advisable to add the mortgagor, but we have already noted that under the mortgage clause the mortgagee seeks relief not as assignee (and thus subject to defences available against the assignor) but as a separate party on a separate contract.

In addition to the grounds adverted to and relied upon by Middleton J.A., reference should be made to the further argument adopted in the leading American case of *Hastings* v. *West-*

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[38] R.S.O., 1937, c. 155, s. 5.

chester Ins. Co.[39] In that case, the court, dealing with the standard mortgage clause and a defence by the company that the mortgagee, even if the clause gave him an enforceable contract, was nonetheless bound by the conditions, not contained in the clause, for further insurance, which were binding on the mortgagor, held that there was a separate and distinct contract by the mortgagee which he could enforce directly without regard to any of the conditions binding upon the mortgagor. It is noteworthy, however, that none of the bases upon which such a contract has, from time to time, been justified in law were even suggested by the court in the *Hastings* case in arriving at its decision; on the contrary, the gravamen of the judgment was that:

> . . . the intention of the parties was, beyond question, to insure the plaintiffs under a new contract. *Any different interpretation would lead to great injustice,* and place the mortgagees under the control and at the mercy of the owner. . . . If before the arrangement with the defendant, as was the case here, the contract created by the mortgage clause would be seriously affected, and the security intended to be furnished thereby very much impaired [*sic*]. There is no valid ground for the assumption that either party intended any such result. . . . The just and reasonable interpretation of the provision, in accordance with the rule laid down under the facts presented is, that the legal force and effect of the policy shall not be weakened or impaired. . . . Any other construction would be loose, indefinite, unsatisfactory, and render the clause in question of but comparatively little value. . . .[40]

That this view may have been a major basis for the judgment in the *London Loan* case appears from a similar statement by Middleton J.A.:

> The matter does not appear to be of great practical moment, for, in my view, the Court would not permit the plaintiffs' right to be defeated for this reason, but would add all necessary parties as plaintiffs if they consented, or as defendants if the consent was refused, *so that justice might not be defeated.*[41]

One would think that contractual rights cannot be created in law merely through the recognition of a wish, however desirable, to give effect to what the parties may be supposed to have intended.

Relevant to the problem of the mortgagee's independent right of action under the mortgage clause is the statutory provision contained in section 95(2) of the Insurance Act. In this respect reference should be made to the judgment of the Ontario

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[39] (1878), 73 N.Y. 141.
[40] At pp. 148 *et seq.* (italics mine).
[41] (1925), 57 O.L.R. at p. 653 (italics mine).

Court of Appeal in the recent case of *Farmers Mutual* v. *Hanrahan*, where it was said (*per* Middleton J.A.)[42] that:

> This right [of the mortgagee to sue] was conferred by statute, which is now known as the Insurance Act, R.S.O. 1937, ch. 256, s. 95, sub. sec. 2. This statute provides that, after the sixty days, or shorter period stipulated, a beneficiary entitled to the insurance money and having the right to receive the same and to give an effectual discharge therefor, may sue for the same in his own name, any rule or stipulation to the contrary notwithstanding.

It should be noted, however, that the right thus given to the mortgagee is subject to the condition named, *i.e.*, that the mortgagee is entitled to give an effectual discharge; as I have already remarked, the case might well arise where there was a dispute between the mortgagor and the mortgagee over the amount of the loss, or where the loss is greater than the mortgagee's claim, or where the company, having paid an arbitrated loss to the mortgagor, is sued by the mortgagee on the ground that the amount so found was insufficient, and in all these cases it is difficult to see how the mortgagee would be able to give a valid discharge and thus satisfy the statute. In such cases the mortgagee's independent right to sue would still depend upon the establishment of a separate contract.

Having regard, therefore, to the doubtful substance of the grounds upon which a separate and independent contract between the insurance company and the mortgagee has been sought to be based, it is not difficult to agree with the dictum of Davies J. in his judgment in the *Agricultural Loan & Savings* case:[43]

> It was contended . . . that the mortgage clause constituted a specific and independent agreement. . . . The question is one of some doubt and there are some observations made in cases already decided in this court which seem to support . . . the contention, but it is not necessary for us to decide the point on this appeal. The decisions upon the point in the courts of the United States do not seem to agree as to the reason of the rule permitting mortgagees to sue in their own names nor as to the precise extent of the rule, while in England there does not appear to be any decision upon this special point.[44]

In conclusion it is interesting to note that the doubt expressed by Davies J. presented itself some ten years later to a commentator in the Harvard Law Review,[45] who complained that:

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[42] [1941] O.R. 163, at p. 165.

[43] (1903), 33 S.C.R. at pp. 108-109.

[44] It was in view of this statement of Davies J. and of the conflicting Canadian decisions that the writer suggested, in reviewing the problem in Best's Insurance News of New York, March 20th, 1931, that it would be desirable if the point could eventually be brought before the Supreme Court of Canada for direct decision.

[45] (1915), 29 Harv. Law Rev. at p. 334.

Reasons for this bi-contractual theory are not forthcoming, except that it is a method of reaching a desired result. See *Hartford Fire Ins. Co.* v. *Olcutt*, 97 Ill. 439. Though it is arguable, it does not seem desirable to stretch the mere agreement by the owner to insure for the mortgagee's benefit into a delegation of power to the former to enter a contract in the latter's behalf. This speculation aside, the requisites of a contract relation are lacking. The mortgagee is not a party to the agreement, and gave no consideration, either executed or promissory. In truth, there are not two contracts . . . .

Stare Decisis and Abolition of Appeals to the Privy Council

In addition to the power to hold legislative acts invalid, a written constitution confers another and perhaps as great a power. It is the power to disregard prior cases. "The ultimate touchstone of constitutionality is the constitution itself, and not what we have said about it", Justice Frankfurter has written. The problem of stare decisis where a constitution is involved is therefore an entirely different matter from that in case law or legislation. This is often overlooked when the court is condemned for its change of mind. A change of mind from time to time is inevitable when there is a written constitution. There can be no authoritative interpretation of the Constitution [the American Constitution]. The Constitution in its general provisions embodies the conflicting ideals of the community. Who is to say what those ideals mean in any definite way? Certainly not the framers, for they did their work when the words were put down. The words are ambiguous. Nor can it be the Court [the Supreme Court of the United States], for the Court cannot bind itself in this manner; an appeal can always be made back to the Constitution. Moreover, if it is said that the intent of the framers ought to control, there is no mechanism for any final determination of their intent. Added to the problem of ambiguity and the additional fact that the framers may have intended a growing instrument, there is the influence of constitution worship. This influence gives great freedom to a court. It can always abandon what has been said in order to go back to the written document itself. It is a freedom greater than it would have had if no such document existed. The difference in the British practice is revealing. But this may say no more than that a written constitution, which is frequently thought to give rigidity to a system, must provide flexilibity if judicial supremacy is to be permitted. (Edward H. Levi: An Introduction to Legal Reasoning (1949). Chicago: The University of Chicago Press)