MORTGAGE CLAUSE IN FIRE INSURANCE POLICIES.*

The law of fire insurance has perhaps developed more in United States than in any country and the decisions of American courts are looked upon with great respect, not only in Canada, but also in England, and the decisions and principles found in American cases are often embodied in Canadian and English decisions. In this connection, it might be of interest to note what has been judicially said on this point. In the case of *Corey* v. *Burr*,[1] Lord Justice Brett said: "If I thought that there were American authorities clear on this point, I do not say I would follow them, but I would try to do so, for I agree with Chancellor Kent, that with regard to American insurance law, it is most advisable that the law, should, if possible, be in conformity with what it is in all countries. I must further add, that although American decisions are not binding on us in this country, I have always found those on insurance law to be based on sound reasoning and to be such as ought to be carefully considered by us with an earnest desire to endeavour to agree with them." These remarks of Brett, L.J., were quoted with approval by the late Justice J. E. Rose in an unreported Ontario case[2] and statements to the same effect have been made in many Canadian cases. The article above referred to of February 20, 1930, dealt largely with the effect of the mortgagor taking out additional insurance without the knowledge or consent of the mortgagee, and also considered the effect of the New York standard mortgage clause with respect to the acts of the mortgagor subsequent to the issue of the policy. The article of August 20, 1929, dealt with the rights of the mortgagee under the "union mortgage clause" which was interpreted therein to mean that "the policy as to the mortgagee's interest, is not invalidated by any act or neglect of the mortgagor or insured of which the mortgagee had no knowledge, either before or after the issuance of the policy." The present article discusses these points and the difficulties arising from Canadian decisions on the mortgage clause. With this in view, it might be of assistance to lawyers and insurance executives who may not be familiar with Canadian insurance decisions, to point out the attitude our Courts have taken in regard to the interest of the mortgagee apart from the mortgage clause.

* EDITOR'S NOTE.—Reprinted by permission from Best's Insurance News, New York.

[1] (1882), 9 Q.B.D. 469.

[2] See C.E. Digest Sec. 38.

It is perhaps almost too elementary to state that where an insurance company insures the interest of the mortgagee only, it is, on payment, subrogated to the rights of the mortgagee, as the policy is one of indemnity and nothing more, but it seems advisable to remember this because the mortgage clause is often spoken of as one whereby an insurance company is subrogated to the rights of the mortgagee. This statement is not quite accurate because if the insurance is of the mortgagee's interest only, then without any mortgage clause, there is of course subrogation on payment of loss, but where the insurance is taken out in the name of the mortgagor and paid for by the mortgagor or chargeable to him under a covenant to insure in the mortgage, it is primarily an insurance of the mortgagor's interest. In this case the mortgage clause gives no additional rights to the insurance company against the mortgagor, at least where it is attached without the consent of the mortgagor. This is obvious, because a mortgage clause attached at the request of the mortgagee, cannot alter the contract between the mortgagor and the company.[3] Of course if the mortgagor authorizes the attachment of the mortgage clause, he might be estopped from disputing its terms but as the clause only operates if he is unable to collect on his policy for his own interest, he can have no objection; he has no insurance and owes the mortgage monies and it makes no difference to him, if by subrogation, the insurance company becomes entitled to the mortgage.

Notwithstanding that such insurance is primarily an insurance of the mortgagor's interest, it has been held in the Province of Ontario that the mortgage clause constitutes a separate contract between the insurance company and the mortgagee, protecting the mortgagee's interest and gives the mortgagee a right of action against the insurance company. The latest case was on the usual form of mortgage clause as provided by the Canadian Fire Underwriters' Association.[4] This decision reviews most of the earlier cases and the trial court followed *Hastings* v. *Westchester Fire Insurance Co.*[5] The action covers other questions discussed later herein, but at this point only the form of the action is considered. It was claimed that the mortgage clause gave no independent right of action to the mortgagee. The Court of Appeal held to the contrary and so the law is settled for Ontario. In this connection it should be stated that under the Ontario Insurance Act[6] a beneficiary or person to

[3] *McKay* v. *Norwich Union* (1898), 27 O.R. 251.
[4] *London Loan & Savings* v. *Union Insurance Society of Canton Limited* (1925), 56 O.L.R. 590, affirmed in the Court of Appeal 57 O.L.R. 651.
[5] (1878), 73 N.Y. 141.
[6] R.S.O. 1927 Chapter 27 Section 89(2).

whom a policy is payable, has the right to sue on the policy where he can give a discharge for the monies payable thereunder, but this section was not referred to by the Court in the above-mentioned case and possibly its application is restricted to cases where the mortgagee's claim is at least equal to the amount of the loss, otherwise there would always be the question of the interest of the mortgagor for which the mortgagee would be unable to give a discharge. Although this is the law in the Province of Ontario, it is essential to point out that the Supreme Court of Canada in two cases has doubted whether there was any such separate contract between the insurance company and the mortgagee under a mortgage clause.[7] In the earlier case the matter is discussed on the basis of a contract between A and B not giving any rights to C and quoting the general rule of English law to that effect.

As a matter of interest, although not affecting the mortgage clause, it is perhaps worth noting that the Courts in Ontario at least, have struggled violently in cases where there was no mortgage clause or prior to its general use, to give the mortgagee a right of action independently of the mortgagor (assured). Sometimes this was justified on the ground that the policy was a deed poll and that the mortgagee as one of the named persons therein could sue; sometimes on the ground that the mortgagor was a trustee and that the monies were impressed with the trust and that the mortgagee had a lien thereon under the covenant to insure in the mortgage and could sue to collect the insurable monies as the person beneficially entitled. Now that the mortgage clause is of general use, these cases are of little interest. In the *London Loan* case the Courts were not bound by the cases in the Supreme Court of Canada, as the doubts therein expressed were not necessary to the decision of those cases. The law appears to be the same in the province of Alberta as it is in Ontario, as was held in the case of *Laidlaw* v. *Hartford Fire Insurance Co.*[8] that the mortgagee could sue the company on a policy to which there had been attached the usual mortgage clause on the ground that either the existing contract was a tripartite one to which he was a party or that he is the principal and the assured his agent, or that he is the cestui que trust of the assured. This case had been followed ever since in the Alberta Courts including the Court of Appeal. On the other hand, it has been held in the Court of Appeal for British Columbia in the case of *National Fire Insurance Co.* v. *Emerson*[9] that there is no privity

[7] *Guerin* v. *Manchester Fire Assurance Co.* v. *Agricultural Savings and Loan Co.* (1903), 33 S.C.R. p. 94.
[8] (1916), 10 A.L.R. p. 7.
[9] (1914) 22 B.C.R. 349.

of contract between the insurer and the mortgagee although a mortgage clause was attached to the insurance policy in that case. This seems the only decision on the point in British Columbia. These cases would seem to be in direct conflict. Possibly the question will go to the Supreme Court of Canada in some cases of sufficient importance, where there are also other defences.

If the insurance company recognizes the mortgagee's claim, but disputes liability to the mortgagor (assured) the question arises whether the company on payment to the mortgagee, has an immediate right to be subrogated to the position of the mortgagee. A decision of the Supreme Court of Canada is reported as having held that an insurance company cannot sue the mortgagor on the mortgage after payment to the mortgagee of all his interest unless and until the insurance company shall have established in a separate action, that the mortgagor has as against the insurance company, no right of action. *Imperial Fire Insurance Co.* v. *Bull*,[10] where, although no reasons for judgment are quoted, the headnote is in part as follows: "Held, also, that the company were not justified in paying the mortgagees without first contesting their liability to the mortgagor and establishing their indemnity (sic freedom) from liability to him; not having done so, they could not, in the present action, raise any questions which might have afforded them a defence in an action against them on the policy." On looking at another report of that case in Cameron's Supreme Court Cases p. 1 where alone the reasons for judgment are given, it is found that there was no such decision and that only two judges out of the four comprising the Court, concurred in so holding. Consequently it is not the Court's decision on this point, although valuable as an expression of opinion. The statement quoted was made on dismissing an appeal from *Bull* v. *North British Investment Limited and Imperial Fire Insurance*,[11] where that point was not discussed and so the only result is to affirm the decision appealed from which was merely that the right of an insurance company to be subrogated under the usual mortgage clause depends upon whether it has a good defence against the mortgagor and it not being so shown by the objections raised by the insurance company, the payment to the mortgagee enured to the benefit of the mortgagor. There seems to be no good reason why such questions need be litigated in a separate action against the mortgagor by the insurance company before it sues on the mortgage. The insurance company's reasons for disputing liability to the mortgagor on the policy, or in other words,

[10] (1891), 18 S.C.R. p. 697.
[11] (1888), 15 O.A.R. 421.

the company's right to the mortgage, which of course depends on there being no liability to the mortgagor on the policy might well be raised by the mortgagor in an action against him on the mortgage.

It is regrettable that the erroneous headnote in the Supreme Court of Canada above quoted was adopted and followed by the Ontario Court of Appeal in *McKay* v. *Norwich Union*[12] as if it had been the judgment of the Court as appears by the following statement at p. 265 in the *McKay* case: "That case establishes that an insurance company, having entered into a subrogation agreement, similar to that here in question, with a mortgagee, who insured for the mortgagor, as well as himself, or who holds as mortgagee, a policy taken out in the name of the mortgagor cannot after paying the mortgagee a loss incurred under the policy, take an assignment of the mortgage and hold it against the mortgagor, even though they could shew, if allowed to do so, that the mortgagor, apart from the terms of the subrogation agreement, never had any claim against them." The decision in the case was that although the insurance company had established that the mortgagor had no claim against it on the policy and that it had paid the mortgagee under a mortgage clause, yet the company could not enforce the mortgage against the mortgagor. This judgment complicates a situation already involved, and is one, it must be said, which is not warranted on principle or authority, because it is clear that if the insurance company paid the mortgagee, it must have been for the mortgagee's interest, the mortgagor having been held to have none, and so subrogation would apply. Furthermore, the words "apart from the subrogation agreement" are misleading and meaningless as of course the mortgage clause gives no right to the mortgagor at any time. Again no report of the *Bull* case even purports to say that an insurance company cannot show that it is not liable to the mortgagor and so entitled to hold the mortgage against the mortgagor, but merely that in an action by the insurance company on the mortgage, it cannot claim, in order to show title to the mortgage, that the mortgagor had no claim on his policy, if this has not been established in a prior action. Actually, there was of course, no such decision. However, nothing can be done now until some case involving these questions goes to trial, when it is possible these decisions might be distinguished.

The right of action by the mortgagee on the mortgage clause and the insurance company's rights on payment of the mortgagee's claim having been discussed, it remains only to consider when the mortgagee is entitled to claim under the mortgage clause and what restrictions govern the rights therein given to him. In the mortgage

[12] (1898), 27 O.R. 251.

clause in Canada and in the standard mortgage clause in the United States there is a provision that the "insurance as to the interest of the mortgagee, only, herein, shall not be invalidated by any act or neglect of the mortgagor or owner of the property insured." In the article in Best's Insurance News of February 20, 1930, there was an interesting discussion as to whether this wording included protection against an act of the mortgagor in obtaining the policy or whether it was limited to the subsequent acts of the mortgagor. It was argued that the object of the mortgage clause was to give absolute security to the mortgagee so that he could rely on its protection when delivered to him and cases were cited giving effect to this view for which of course there is much to be said. On the other hand, cases might be cited which hold that the mortgagee was not protected when the policy was e.g., obtained by misrepresentation on the part of the mortgagor. One reason for this latter view is that the insurance companies probably only give the mortgagee the protection by attaching the mortgage clause on the assumption that the companies are validly on the risk and do not intend or agree to do so in situations where the policy had been issued on misrepresentation, or where for any reason there was no valid contract. This latter is the view which has obtained recognition in Canada, it having been held that such words in the clause only apply to the subsequent acts of the mortgagor and that where by reason of misrepresentation the policy was void from inception, the mortgagee had no rights under the mortgage clause.[13]

On the question of the insurance company's liability under the clause where there has been a failure by the mortgagee to comply with its conditions, it should be noted that in the case of *London Loan and Savings* v. *Union Insurance* (*supra*) it was held that failure of the mortgagee to "at once notify the said insurance company of any change of ownership—that shall come to their knowledge—" as required by the mortgage clause, does not defeat the mortgagee's claim although the mortgagee might be answerable in damages if any could be shown.

This simply means that such failure does not go to the root of the contract and its insertion is really valueless because it is difficult to conceive of any case where damages could be shown. A company could not say it suffered measurable damages because A had bought the property from B, although it is a change material to the risk. A company usually consents to such a transfer and although desir-

[13] *Omnium Securities* v. *The Canadian Fire & Marine Insurance Co.* 1 O.R. 494 and *London & Liverpool and Glove* v. *Agricultural Savings* (*supra*), which latter case is authoritative throughout Canada.

ous of having the opportunity of going off the risk if it does not wish to consent, it is impossible to prove damages because it was not given the opportunity. The Court held that as the mortgage clause did not provide a penalty by avoiding the policy for such failure to notify, the breach sounded in damages only. In so holding the Court approved the cases of *Pioneer Savings* v. *Providence Washington Insurance Co.*[14] and *Whitney* v. *American Insurance Co.*[15]

In conclusion, the situation at present in Ontario and Alberta is that a mortgagee may bring an action on an insurance policy to which a mortgage clause is attached, independently of the mortgagor. Opposed to this it has been held in British Columbia as hereinbefore stated, that he has no such rights and the Supreme Court of Canada has cast doubts on the existence of such a right. If an insurance company recognizes a mortgagee's claim under a mortgage clause and pays him, it is said to have been held that it must first bring an action to establish that it had no liability to the mortgagor (assured) on the policy before it can claim to be subrogated to the mortgagee's rights. It is hoped that it has been shown that such is not the law and that all it need do is to show when it sues on the mortgage that the mortgagor had no claim on the policy. Lastly the failure of a mortgagee to notify the insurer of a change of ownership as "provided and agreed" in the mortgage clause results in his being answerable only for the damages flowing from such breach if any can be shown, which is extremely unlikely, but does not affect his right to recover.

The above is submitted to be the result of the decisions at present and though some of the principles do not seem to be justifiable, until such time as there are further authoritative decisions changing the law, the rights and liabilities under a mortgage clause are governed by the principles enunciated in this article.

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[14] (1897), Wash. 175 49 Pac. Rept. 231.
[15] (1899), 56 Pac. Rept. 50, 59 Pac. 897.