The Mortgage Clause in Fire Insurance Policies

Paper read before the Vancouver Insurance Institute, February 11th, by Mr. E. Spencer, manager of the insurance department of the Yorkshire and Canadian Trust.

This clause is one of the most common, but at the same time one of the most important clauses in use on fire policies at the present day. It is very extensively used, more particularly so in Vancouver, where we find practically every building is mortgaged.

There are numerous kinds of so-called mortgage clauses but I am just going to deal with the Standard Form of New York.

To read this form through one would not be given the impression that there was anything which would be likely to cause any dispute in the event of a loss as it states clearly the meaning the company intend to convey to the mortgagee.

Unfortunately, however, the meaning so set out is not adhered to when the clause comes before the courts, as by juggling with it they are able to place a different aspect on the various sections of the clause to the benefit of the mortgagee in practically all cases, and it is these points to which I will refer.

It is a well established principle in insurance law that a fire insurance policy containing a mortgage clause becomes a special contract with the mortgagee and that the mortgagee is not bound by the conditions which restrict the rights of the assured. This is brought about by the provisions of the mortgagee clause which state "that the policy shall not be invalidated by any act or neglect on the part of the mortgagor" in so far as the mortgagee's interest is concerned. There is, however, a limit to the proviso, for although liberties may be taken with the printed portion of the policy the written portion must always be respected. As an instance, I might mention the co-insurance clause, which if not complied with and applicable, would impair the rights of recovery of the mortgagee the same as it would the assured.

This special contract between the company and the mortgagee comes into existence as soon as the mortgagee clause is attached to the policy, but does not become active until there is some default or breach of conditions of the policy.

We very often find in the wording of a policy, "Loss, if any, payable to......................., mortgagee, as his interest may appear, as per mortgage clause attached." This clause is a very troublesome one, and has on many occasions made the companies pay losses for which they were not liable. The intention of the clause is, that loss, if any, shall be payable to John Doe, mortgagee, as his interest may appear **as mortgagee,** the balance, if any, to go to the assured. The courts, however, construe the words "as his interest may appear" to mean such interest which by proper proof can be shown to exist at the time of the fire. John Doe, mortgagee, just designates who John Doe is; as his interest may appear, covers any interest he may have in the property at the time of the fire, whether it be that of mortgagee or owner.

There is no need for the clause as the company would pay the amount due the mortgagee, the balance going to the owner without the clause on the policy.

A mortgagee during foreclosure proceeding is fully protected under the mortgage clause, but as soon as foreclosure proceedings have been consummated his position changes somewhat; he then becomes owner, and as such bears a different relationship to the property involved than formerly. His rights under the policy also undergo a change which must be provided for as he is no longer entitled to the benefit of the mortgage clause.

An interesting case came before my notice a little while ago in connection with a foreclosure. For illustrating purposes, we will say the owner was "A" and the mortgagee "C." A policy was issued to "A" with loss payable to "C" with the mortgage clause attached which contained the usual provision that "any act or neglect on the part of the mortgagor shall not invalidate the mortgagee's interest." "A" sold to "B" but the policy was not assigned. A fire occurred on, say, the 1st of January, and on the 1st of March the mortgagee foreclosed on the property and bought it at the mortgage sale. The company refused payment of the loss on the grounds that when the loss occurred the policy was invalid as to the mortgagor though still binding as regards the mortgagee. The then mortgagee, now owner, by foreclosing on the property had released the mortgagor and taken away from the company the rights of an assignment of the mortgage, which right the company was entitled to under the last section of the mortgage clause. It is not necessary for a company to demand an assignment of a mortgagee until payment of the loss is actually made.

"Provided that in case the mortgagor or owner shall neglect to pay any premium due under this policy the mortgagee shall on demand pay same." To read this clause one would naturally be given the impression that if a mortgagor neglected to pay the premium the mortgagee could be called upon to pay same, and if he refused, action could be taken against him under the conditions of the mortgage clause. However, this brings us back to the separate contract between the company and the mortgagee, which, as I have previously stated, comes into existence at the time the mortgage clause is attached to the policy, but not active until there is a breach of the conditions or on account of non-payment of premium.

I have in mind a case where a policy ran for six months and was then cancelled by the company for non-payment. The company relying on the stipulations I have referred to, that the mortgagee would on demand pay the premium, took action against the mortgagee for the time they were on the risk, but the court ruled that the clause referred to only became active when the company demanded payment of the premium from the mortgagee, and he had the option of paying the premium and have the policy continue in force or cancel the policy, no liability attaching to him for payment except from the date of demand.

This to my mind was a very unreasonable decision, especially as the intent of the clause "this policy shall not be invalidated as regards the mortgagee's interest by any act or neglect on the part of the mortgagor" is very clear, that in consideration of certain privileges the mortgagee is to give some return and that is guarantee the premium.

"The company reserves the right to cancel this policy —10 days' notice to the mortgagee." Under the statutory conditions it is necessary when cancelling a policy to give the assured 5 days' written notice, but under the mortgagee's special agreement he is entitled to 10 days' notice. The variations of these two terms of cancellation is likely to cause no little trouble. For instance, if there is a policy for $10,000, the mortgagee's interest in which is $5,000, the company gives 5 days' notice to the assured and 10 days to the mortgagee, on the 6th day there is only $5,000 in force and should a loss occur between the 5th and 10th days the company would be liable to the mortgagee up to this amount. The point, however, at which I am trying to arrive at is the date on which the policy is cancelled to figure the earned premium. I have no definite information on this point, but my opinion is that the earned premium should be figured from the 10th day when the liability to the mortgagee has ceased. There is also another question with regard to the 10 days' notice of cancellation to the mortgagee which would arise should the insurance be replaced by the assured between the 5 and 10 days that is, the payment of the loss should a fire occur. The property would be covered for $15,000 although the intention is that