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Insurance - Binding Effect on Mortgagee of Settlement Between Insured and Insurer

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INSURANCE—BINDING EFFECT ON MORTAGEE OF SETTLEMENT BETWEEN INSURED AND INSURER

Insured bought a truck from the Elliott Equipment Company, Bristol, Tennessee. She paid part cash and signed a conditional sale contract for the balance of $3,684. The seller assigned the contract to the plaintiff bank, and the latter's lien was duly endorsed on the truck's certificate of title. On the date of the purchase, insured obtained from defendant insurance company a physical damage policy containing the usual loss payable clause, with a stipulation as to the procedure to be adhered to in case of disagreement between the insured and the insurer as to the amount of loss incurred:

> Loss Payee: Any loss hereunder is payable as interest may appear to the insured and Union Trust Corporation, Bristol, Tennessee.
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> . . . . .
>
> The limit of the company's liability for loss shall not exceed the actual cash value of the automobile, or if the loss is of a part thereof the actual cash value of such part, at time of loss nor [*sic*] what it would then cost to repair or replace the automobile or such part thereof with other of like kind and quality, with deduction for depreciation nor [*sic*] the applicable limit of liability stated in the declarations.

While the policy was in force and the identity of the parties remained unchanged, the truck sustained severe collision and fire damages. After some negotiation insured, on advice of counsel, accepted $700 as a compromise settlement and executed an agreement releasing the defendant insurer from further liability. Plaintiff bank during the negotiations *refused to take any part,* although it had notice. The defendant issued its $700 draft payable to the plaintiff bank, the insured, and the repairman. The plaintiff refusing to endorse, the repairman obtained judgment for $344.33, which was paid by the defendant. The balance of the settlement, $355.67, was paid by an additional draft drawn payable to the plaintiff and the insured. The plaintiff again refused to endorse and instituted the instant action for $1,396 and interest, the full amount for which it contends the insurance company is liable, claiming that the damage to the vehicle was in excess of its instant claim. The plaintiff obtained in the Corporation Court of the City of Bristol a jury verdict of $1,218.42, subject to a credit for the

$355.67 draft. On appeal, *held,* judgment entered for the plaintiff in the amount of $355.67, but in other respects reversed and final judgment for the defendant. *Provident Fire Ins. Co.* v. *Union Trust Corp.,* 195 Va. 415, 78 S.E.2nd 584 (1953).

The union mortgage clause stipulates that if the loss is directed to be payable to the mortgagee, his interest can not be affected by any act or omission of the mortgagor.[1] When a simple loss payable clause appears in the requirement of insurance in a deed of trust, it is apparently construed in Virginia to mean "full contribution in favor of the trustee *as his interest may appear*".[2] [Italics supplied]. The *Provident* case is illustrative of the Virginia view that the creditor under the simple loss payable clause is bound by the negotiations between the insured and the insurer. In *Home Loan & Finance Co.* v. *Fireman's Fund Ins. Co.,*[3] the Alabama court gave the corollary that the absence of the union mortgage clause makes the wording necessarily mean "simple loss payable". In that case the insured forfeited his fire policy because he permitted complete change of ownership without the insurer's consent; it was held that, in the absence of a union mortgage clause, the creditor's claim to the proceeds must fail. In succinct language, the court in *Prudential Ins. Co. of America* v. *German Mutual Fire Ins. Assn.*[4] said:

> A policy that simply provides that it shall be payable to the mortgagee as his interest may appear is called an "open mortgage clause", and is the character of mortgage clause *pleaded* in the *petition.* This clause is to be distinguished from the "union mortgage clause". In the latter clause it is stipulated, in substance, that in case of loss the policy is payable to the mortgagee and that his interest as payee shall not be invalidated or affected by any act or omission of the mortgagor. Where there is merely an open mortgage clause there is no *privity created between the company and the mortgagee, he not being a party to the contract but merely an appointee to receive the proceeds in case of loss.* [Italics supplied]. His rights will be defeated by a breach of the conditions of the policy by the mortgagor.[5]

1. New Burnswick Fire Ins. Co. v. Morris Plan Bank, 136 Va. 402, 118 S.E. 236 (1923); Home Loan & Finance Co. v. Firemen's Fund Ins. Co., 221 Ala. 529, 129 So. 470 (1930); Prudential Ins. Co. of America v. German Mutual Fire Ins. Assn., 231 Mo.App. 699, 105 S.W.2nd 1001 (1937).
2. Virginia Code of 1950, §55-60(8).
3. 221 Ala. 529, 129 So. 470 (1930).
4. 228 Mo.App. 139, 60 S.W.2d 1008 (1933).
5. 228 Mo.App. 139, —, 60 S.W.2d 1008, 1009 (1933).

A review of the cases outside Virginia leads to no definite conclusion as to whether the weight of authority is for or against construing the union clause as a separate contract,[6] or as an appendage to the policy to be construed in the light of other provisions.[7] The *Home* case[8] would not let the union clause have the effect of permitting the *mortgagee* to recover where the *mortgagee* procured additional insurance prohibited by the policy. In *Trepanier* v. *Mercantile Ins. Co.*,[9] the tenant was the mortgagee and plaintiff, while the purchaser was the insured under a policy which was to be void if the premises were unoccupied for 30 days. In ordering a new trial, the court observed that unoccupancy by the mortgagee for the specified period would defeat its recovery. The *Home* and *Trepanier* cases develop the obvious point that under either form of loss payable clause, acts of the *mortagee* will prejudice the *mortgagee* where those acts would have avoided the policy if done by the *mortgagor*. A case from the Ninth Circuit[10] goes so far as to state that the acts or omissions of the mortgagor, even before the endorsement of the union clause, do not prejudice the mortgagee after the endorsement of the union clause, where the mortgagee had no notice of the infirmities at the time of this endorsement.

In the writer's opinion, even the union mortgage clause would not have protected the mortagee in the *Provident* case, *supra*. There the mortgagee had notice, and his silence operates as an estoppel. The mere fact that a policy contains one or the other type of mortgage clause does not of itself mean that the mortgagee is protected against acts or omissions of the mortgagor. He cannot simply be an ostrich and ignore notice given him.[11] The author of a recent case note[12] disagrees and states, relative to the *Provident* case, "Foresight by the mortgagee in requiring a standard mortgage clause would have provided the broad protection sought in this action."[13] A Minnesota case, *First National Bank of Duluth* v.

6. Union Assurance Society v. Equitable Trust Company, 127 Tex. 618, 94 S.W.2d 1151 (1936); Guaranty Life Ins. Co. v. Farmers Mutual Ins. Assn., 224 Iowa 1207, 278 N.W. 913 (1938); Prudential Ins. Co. of America v. German Mutual Fire Ins. Assn., 142 S.W.2d 500 (Mo. 1940); Kligerman v. Union & New Haven Trust Co., 127 Conn. 622, 18 A.2d 683 (1941).
7. Home Ins. Co. of New York v. Lake Dallas Gin Co., 127 Tex. 479, 93 S.W.2d 388 (1936).
8. *Ibid.*
9. 88 N.H. 118, 184 A. 866 (1936).
10. Tarleton v. De Veuve, 113 F.2d 290, 132 A.L.R. 343 (9th Cir. 1940), *cert. denied* 312 U.S. 691 (1940); accord, Citizens State Bank of Clare v. State Mut. Rodded Fire Ins. Co., 276 Mich. 62, 267 N.W. 785 (1936); Union Trust Co. of Ellsworth v. Philadelphia Fire & Marine Ins. Co., 127 Me. 528, 145 A. 243 (1929).
11. St. Louis Fire & Marine Ins. Co. v. Witney, 96 F.Supp. 555 (M.D.Pa. 1952).
12. 40 Va.L.Rev. 234 (1954).
13. *Id.* at 237.

National Liberty Ins. Co.,[14] might seem to lend support to his contention, for there is considerable authority holding that the mortgagor under such a clause can not by his own acts prejudice the position of the mortgagee without his consent to those acts.[15] However, the Minnesota court clothed what was on its face a simple loss payable clause with the attributes of the union clause. Aside from this, the distinction between the *Provident* and the *First National* cases is that in the former the opportunity for the bank to speak was when it was given notice that the insured was negotiating with the insurer. The parties to the negotiations afforded the bank the right to participate, which was not exercised. Hence, under either form of loss payable clause, it is submitted, the bank has no rights under the circumstances.

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14. 156 Minn. 1, 194 N.W. 6 (1923).
15. *E.g.* Hathaway v. Orient Ins. Co., 134 N.Y. 409, 32 N.E. 40 (1892).