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## Insurance - Recovery - Rights of Mortgagee Under Mortgagor's Insurance

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INSURANCE — RECOVERY — RIGHTS OF MORTGAGEE UNDER MORTGAGOR'S INSURANCE—Defendant issued a policy of fire insurance on an automobile plaintiff had purchased with money borrowed from one Hansen, to whom a note and a chattel mortgage were given as security for the debt. A week after the policy was issued naming plaintiff as the insured, defendant executed an amendment to the policy in the form of an endorsement reading, "Less if any . . . shall be paid to the insured and Charles H. Hansen as their interests may appear." The policy provided that it should not apply while the car was subject to any mortgage or other encumbrance not specifically declared and described in the policy. The premium was paid by Hansen. After the automobile was destroyed by fire, plaintiff sued on the policy and the defendant demurred, alleging failure to state a cause of action. The demurrer was overruled and judgment entered for plaintiff and Hansen. Defendant then amended its petition to allege that plaintiff had executed three additional chattel mortgages on the car that violated the provision against encumbrances. *Held*, admitting the policy might be void as to plaintiff, this does not affect defendant's liability to Hansen. *Koenke v. Iowa Mut. Cas. Co.*, 175 Kan. 473, 264 P. (2d) 472 (1953).

In considering the rights of a mortgagee under a policy of fire insurance taken out by the mortgagor or owner of a chattel, the courts have traditionally drawn a distinction between the "open" mortgagee clause and the "standard," or "union," mortgagee clause. Under the former the mortgagee is considered a mere appointee of the mortgagor subject to all the defenses the insurer may have against the mortgagor.<sup>1</sup> Under the latter it is commonly held that the mortgagee has an independent contract with the insurer<sup>2</sup> and is barred from

<sup>1</sup> 1 RICHARDS, INSURANCE, 5th ed., 594 (1952).

<sup>2</sup> For criticism of the "independent contract" theory in favor of treating the mortgagee as a third party beneficiary, see 33 COL. L. REV. 305 (1933).

recovery only by his own defaults.<sup>3</sup> In interpreting policies of insurance, with respect to these two clauses, various courts have construed different language in different ways, even to the extent of reaching opposite results from the same language,<sup>4</sup> but with an overall trend toward a construction favoring the mortgagee.<sup>5</sup> The court in the principal case construed the clause, "Loss if any . . . shall be paid to the insured and Charles H. Hansen as their interests may appear," as creating a single contract insuring both the mortgagor and the mortgagee in their respective interests.<sup>6</sup> Under this construction, the mortgagee's interest was insured directly by the insurer and his right to recover was not defeated by any default of the mortgagor.<sup>7</sup> Earlier Kansas cases hold that policies reading, "loss payable to insured and . . . mortgagee," with the additional stipulation beforehand, "subject to all the provisions, exclusions, conditions and warranties contained in this policy," create no independent rights in the mort-

<sup>3</sup> VANCE, *INSURANCE*, 3d ed., 776 (1951); note, 124 A.L.R. 1034 (1940). For the historical development of this clause see Bemant, "The Interest of a Mortgagee under a Policy of Fire Insurance," *THE FIRE INSURANCE CONTRACT, ITS HISTORY AND INTERPRETATION*, Insurance Society of New York (1922).

<sup>4</sup> The clearest case of an "open" mortgagee clause is a policy making the loss payable to the mortgagee, "as his interest may appear, subject to all the terms and conditions of the policy." *Wharen v. Markle Banking and Trust Co.*, 145 Pa. Super. 99, 20 A. (2d) 885 (1941), and cases cited therein. The more common phrasing of this clause reads, "loss payable to . . . mortgagee as his interest may appear." *Hill-Howard Motor Co. v. International Indemnity Co.*, 116 Kan. 109, 225 P. 1056 (1924). The following have also been held to create only derivative rights in the mortgagee: (a) "loss payable to . . . mortgagee." *Grosvenor v. Atlantic Fire Ins. Co.*, 17 N.Y. 391 (1858); (b) "loss payable to insured and . . . mortgagee as their interests may appear." *Brooker v. American Ins. Co.*, 65 Ga. App. 713, 16 S.E. (2d) 251 (1941); *Conard v. Moreland*, 230 Iowa 520, 298 N.W. 628 (1941). The "standard" mortgagee clause reads, "this insurance, as to the interest of the mortgagee only therein shall not be invalidated by any act or neglect of the mortgagor, or owner of the within described property." *Goldstein v. National Liberty Ins. Co. of America*, 256 N.Y. 26, 175 N.E. 359 (1931). However, various courts have held the following to create the same rights in the mortgagee as the "standard" clause: (a) "loss payable to . . . mortgagee." *Commercial Securities Co. v. Central Surety and Ins. Corp.*, (La. App. 1947) 29 S. (2d) 712; (b) "This company agrees to give 30 days notice before cancellation of the policy." *Prudential Ins. Co. v. German Mutual Fire Ins. Assn.*, 228 Mo. App. 139, 60 S.W. (2d) 1008 (1933); (c) "if . . . any interest in the policy exists in favor of a mortgagee . . . the conditions hereinbefore contained shall apply in like manner expressed in such provisions and conditions of the insurance relating to such interest as shall be written upon, attached or appended thereto," where no conditions are attached. *Stamey v. Royal Exchange Assurance Co.*, 93 Kan. 707, 150 P. 227 (1915). And see also 135 Am. St. Rep. 750 (1911).

<sup>5</sup> ". . . if there is a more highly favored party to any contract than a mortgagee under a policy of fire insurance, he has not yet been discovered." *THE FIRE INSURANCE CONTRACT, ITS HISTORY AND INTERPRETATION* 199, Insurance Society of New York (1922).

<sup>6</sup> ". . . the purpose of the endorsement was to have Hansen's interest indicated in the policy and to insure that interest." *Koenke v. Iowa Home Mut. Cas. Co.*, 171 Kan. 565 at 569, 235 P. (2d) 983 (1951). While the court did not talk in terms of the "standard" mortgagee clause, it is apparent that this construction reaches the same result.

<sup>7</sup> See *Strombald v. Hanover Fire Ins. Co.*, 121 Misc. 322, 201 N.Y.S. 67 (1923); *Rent-a-Car Co. v. Globe and Rutgers Fire Ins. Co.*, 158 Md. 169, 148 A. 252 (1929). But see *Brooker v. American Ins. Co.* and *Conard v. Moreland*, note 4 supra.

gagee.<sup>8</sup> The only bases upon which the principal case is distinguishable are (1) that there is no clause expressly subjecting the mortgagee to all the conditions of the policy, and (2) that the mortgagee paid the premiums. The first of these does not seem to be significant. Since the interests of both the mortgagor and the mortgagee were insured under the same contract,<sup>9</sup> there seems to be no good reason why the mortgagee should not be as equally bound by its terms as the mortgagor. As to the second, the general rule is that under a "loss payable" clause, mere payment of the premiums does not give the mortgagee greater rights than the mortgagor.<sup>10</sup> Unless the policy is secured by the mortgagee to insure his own interest in the property he is bound by the terms of the contract and his rights are cut off by any act or neglect of the mortgagor.<sup>11</sup> Since, in the principal case the policy was procured by the plaintiff in his own name and the provision making the loss payable to Hansen was not part of the original policy, Hansen cannot be said to have taken out the policy to insure his own interest in the car. It appears that the Kansas court has made an extension of the rights of the mortgagee that is not warranted in light of their previous holdings, and which is contrary to the general pattern of insurance law. Since the "standard" mortgagee clause was available to the parties<sup>12</sup> and they did not choose to use it, it is submitted that the court should have held the mortgagee to the specific terms of the contract.

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<sup>8</sup> *Deruy Motor Co. v. Ins. Co. of North America*, 146 Kan. 233, 69 P. (2d) 677 (1937); *Elmore v. Royal Ins. Co.*, 154 Kan. 93, 114 P. (2d) 786 (1941). These cases expressly refer to this clause as a "loss payable" clause.

<sup>9</sup> "The original policy and the endorsement must be regarded as a single contract which undertakes to insure the interests of both the plaintiff-appellee and Hansen 'as their interests may appear.'" 171 Kan. 565 at 568.

<sup>10</sup> *Kabrich v. State Ins. Co. of Des Moines*, 48 Mo. App. 393 (1892); *Sias v. Roger Williams Ins. Co.*, (C.C. N.H. 1880) 8 F. 187.

<sup>11</sup> *Liverpool and London and Globe Ins. Co. v. Davis*, 56 Neb. 684, 77 N.W. 66 (1898); 3 COOLEY, BRIEFS ON THE LAW OF INSURANCE, 2d ed., 2385 (1927).

<sup>12</sup> *The Westchester Fire Ins. Co. v. Coverdale*, 48 Kan. 446, 29 P. 682 (1892); and see dictum in *Elmore v. Royal Ins. Co.*, 154 Kan. 93 at 99, 114 P. (2d) 786 (1941).