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INSURANCE-CONSTRUCTION-MORTGAGEE'S INTEREST UNDER AN APPRAISAL CLAUSE

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INSURANCE—CONSTRUCTION—MORTGAGEE'S INTEREST UNDER AN APPRAISAL CLAUSE—Plaintiff-mortgagee sued defendant insurance company to recover the amount allegedly due plaintiff under a fire insurance policy covering a mortgaged building. Plaintiff based its right to recovery on a New York standard mortgagee clause incorporated into a New York standard fire insurance policy.¹ Before the

¹The New York standard fire insurance policy is prescribed in mandatory form in §168, N.Y. Ins. Law, 1949. It is not mandatory to protect the mortgagee; however, if the insured desires to do so, §169 requires that the standard "rider" form prescribed by the insurance superintendent be used.

suit was instituted, defendant had tendered payment to plaintiff in accordance with the findings of an appraisal of loss conducted by the mortgagor and defendant, which fully complied with the terms of the policy.² This tender was rejected by plaintiff, which had no notice of, and did not participate in, the appraisal. Plaintiff contended it was not bound by the appraisal and asserted its rights to take part in selection of the appraiser and formulation of the award. The supreme court, trial term, entered judgment in favor of plaintiff for the amount previously tendered by defendant. Plaintiff appealed to the supreme court, appellate division, which unanimously affirmed the trial court's judgment. On appeal to the New York Court of Appeals, *held*, reversed, three judges dissenting. A standard mortgagee clause in an insurance policy creates a separate and independent insurance of the mortgagee's interest, and operates to free the mortgagee from any act or neglect of the owner, despite the fact that the owner may be, in his own right, proceeding strictly in accordance with the policy terms and conditions applicable to him when the loss occurs. *Syracuse Savings Bank v. Yorkshire Insurance Company*, 301 N. Y. 403, 94 N.E. (2d) 73 (1950).

In essence, a standard mortgagee clause is one providing that no act or neglect of any person other than the mortgagee shall affect the mortgagee's rights or interest in an insurance policy payable to him.³ In New York if the insured desires to have the mortgagee's interests expressly protected by the policy, he must have the insurer append to the end of the standard fire insurance policy the standard "rider" form prescribed by the state insurance superintendent.⁴ The policy, as amended by this standard mortgagee's clause, is held to include two separate and independent contracts, one in favor of the mortgagor and the other in favor of the mortgagee.⁵ Therefore, with one exception,⁶ the courts uniformly hold

² N.Y. Ins. Law §168, 1949 provides: "In case the insured and this company shall fail to agree as to the actual cash value or the amount of the loss, then, on the written demand of either, each shall select a competent and disinterested appraiser and notify the other of the appraiser selected within 20 days of such demand. . . . The appraiser shall then appraise the loss, stating separately actual cash value and loss to each item; and failing to agree, shall submit their differences, only, to the umpire."

³ 29 AM. JUR. §1253 (1938).

⁴ See note 1 *supra*. PATTERSON, *CASES AND MATERIALS ON INSURANCE*, 2d ed., 773 (1947), quotes the "New York Standard Mortgagee Clause for Use in Connection with the First Mortgage Interest in Real Estate" as follows: "Loss or damage, if any, under this policy shall be payable to the aforesaid mortgagee . . . , as interest may appear, and 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, nor by any foreclosure or other proceedings or notice of sale relating to the property, nor by any change in the title or ownership of the property, nor by the occupation of the premises for purposes more hazardous than are permitted by this policy; provided, that in case the mortgagor or owner shall neglect to pay any premium due under this policy, the mortgagee . . . shall, on demand, pay the same."

⁵ RICHARDS, *LAW OF INSURANCE*, 9th ed., §278 (1932). However, see Harnett and Thornton, "Is the Mortgagee a Free Rider," *WIS. L. REV.* 714 (1949), for a brief analysis of the interest created in the mortgagee. The writers feel the mortgagee's status cannot be explained by an independent contract, for the mortgagee is often ignorant of the existence of the policy, and knowledge on his part is no prerequisite to recovery. They negate the existence of a third-party beneficiary contract on the ground that the mortgagee is not barred

that under a standard mortgagee clause the mortgagee is not bound by an adjustment between the insurer and the mortgagor without his knowledge and consent, where no stipulation as to the adjustment procedure is provided within the policy.⁷ Even where the policy expressly provides for such procedure but makes no mention of the mortgagee, the great weight of authority is in accord with the majority opinion in the instant decision that under the standard mortgagee clause the mortgagee is not bound without his knowledge and consent.⁸ However, as the dissenting opinion in the instant decision points out, though the standard mortgagee clause creates an independent contract for the mortgagee's separate benefit, where the mortgagee clause does not set out applicable provisions, one must look to the policy itself for the terms of that separate contract.⁹ The New York standard fire insurance policy provides that the insured and the insurer shall ascertain the loss,¹⁰ and the term "insured" as used throughout the policy clearly does not include the mortgagee.¹¹ Since a definite mode of establishing the loss is set out in the policy itself, and the mortgagee clause is silent as to the mode of appraisal,¹² the mortgagee would logically seem bound by the appraisal. Nevertheless, it is submitted that the majority opinion is the better view. It has long been recognized that the interests of the mortgagor are separate and distinct from the interests of the mortgagee.¹³ The tendency has been to free the mortgagee from the effect of the mortgagor's acts or neglect either prior or subsequent to the loss. This was the dominant reason for the development and widespread adoption of this form of mortgagee clause.¹⁴ Even the dissenting judges recognize that the mortgagee would not be bound by a compromise or an accord and satisfaction between the mortgagor and the insurer when there is a standard mortgagee clause;¹⁵ certainly the mortgagee's security interest is no less adversely affected by an appraisal conducted without his knowledge and consent. Since the view that the mortgagee has an independent contract with the insurer cannot be justified on any contract principle,¹⁶ it is no more anomalous to disre-

by the mortgagor's default. They conclude that this relationship is *sui generis* and cannot be explained by contract principles.

⁶ *Erie Brewing Co. v. Ohio Farmers' Ins. Co.*, 81 Ohio St. 1, 89 N.S. 1065 (1909). The Ohio Supreme Court refuses to recognize that a standard mortgagee's clause creates an independent contract between the mortgagee and insurer.

⁷ RICHARDS, *LAW OF INSURANCE*, 4th ed., §279 (1932). 38 A.L.R. 383 (1925).

⁸ See 38 A.L.R. 383 (1925) and 111 A.L.R. 697 (1937) and the cases cited therein. Also, see in particular *Scottish Union and National Ins. Co. v. Field*, 18 Colo. App. 68, 70 P. 149 (1902); *Beaver Falls Bldg. and Loan Assn. v. Allemania F. Ins. Co.*, 305 Pa. 290, 157 A. 616 (1931); and the dictum in *Collinsville Sav. Society v. Boston Ins. Co.*, 77 Conn. 676, 60 A. 647 (1905).

⁹ This accords with the view of the Massachusetts court in *Dragon v. Automobile Ins. Co.*, 265 Mass. 440, 164 N.E. 383 (1929). It was on the authority of this decision that the appellate division held the mortgagee in the instant case bound by the appraisal.

¹⁰ See note 2 *supra*.

¹¹ *Accord*: *Erie Brewing Co. v. Ohio Farmers Ins. Co.*, *supra* note 6; *Dragon v. Automobile Ins. Co.*, *supra* note 9.

¹² See the New York standard mortgagee's clause set out in full in note 4 *supra*.

¹³ VANCE, *INSURANCE*, 2d ed., §170 (1930).

¹⁴ RICHARDS, *LAW OF INSURANCE*, 4th ed., §279 (1932).

¹⁵ See opinion of Desmond, J., at 94 N.E. (2d) 81 (1950).

¹⁶ See note 5 *supra*.

gard the appraisal clause as applied to the mortgagee, though this disregard, too, is opposed to contract principles.

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