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WHEN DOES AN INSURER'S RIGHT OF SUBROGATION ARISE UNDER A STANDARD MORTGAGE CLAUSE?

Richards Buell Sutton Insurance Law Newsletter

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By recently dismissing an application for leave to appeal, the Supreme Court of Canada has refused to interfere in the Ontario Court of Appeal judgment in *Farmers' Mutual Insurance Company (Lindsay) v. Pinder*, 2009 O.N.C.A. 831, which found that there are two preconditions to an Insurer's entitlement to subrogation under the Standard Mortgage Clause. First, the Insurer must make payment of the loss to the Mortgagee (the Lender). Second, the Insurer must establish that it has no liability to the Mortgagor (the Borrower)/Insured under the policy.

Separate Contract Between Mortgagee (Lender) and Insurer

The Standard Mortgage Clause has been a standard part of property insurance policies for well over a century. The Supreme Court of Canada has stated that, even though the Standard Mortgage Clause is part of the policy between the Insurer and the Insured, it constitutes a second and separate insurance contract between the Insurer and the Mortgagee/Lender: *Caisse Populaire Des Deux Rives v. Société Mutuelle d'Assurance Contre L'Incendie de la Vallée du Richelieu*, [1990] 2 S.C.R. 995. The two contract theory, which is firmly embedded in North American insurance practice, protects the Mortgagee's (the Lender's) interest in the Insured property even when the Insured (the Mortgagor/Borrower) has done something to void the insurance policy. The separate contract between the Insurer and the Mortgagee (the Lender) remains in force even when the insurance policy itself has been voided by an act, neglect, omission or misrepresentation attributable to the Insured. Pursuant to the Standard Mortgage Clause, the Insurer must pay the Mortgagee's/Lender's loss to the extent of the policy limits, even when the Mortgagor Insured has done something to void the insurance policy.

The Standard Mortgage Clause

The Standard Mortgage Clause, as approved by the Insurance Bureau of Canada, has two parts. The first part of the clause stipulates that the insurance policy remains in force as to the interest of the Mortgagee/Lender despite any act, omission or misrepresentation of the Mortgagor/Insured or any change in



use that increases the risk. The second part of the Standard Mortgage Clause provides that, when its requirements are met, the Insurer becomes legally subrogated to all the rights of the Mortgagee/Lender against the Insured to the extent of the payment the Insurer has made to the Mortgagee/Lender. Essentially this second part grants the Insurer an assignment of part or all of the mortgage debt and security (depending on the amount paid to the Mortgagee/Lender).

The Decision in *Farmers' Mutual v. Pinder*

In the *Farmers' Mutual v. Pinder* decision, the Insureds' home and contents were damaged in a fire. The Insureds had a policy of insurance with Farmers' Mutual. The home was subject to a five-year mortgage with the Bank of Montreal. The Insureds submitted a claim to Farmers' Mutual for repairs to the house, damage to contents and additional living expenses. Farmers' Mutual denied the claim on the grounds that the Insured had voided the policy by failing to notify the Insurer of a material change in the risk and because they had made wilfully false statements with respect to their claims for contents and additional living expenses. Farmers' Mutual paid the bank the amount owing on the mortgage pursuant to the Standard Mortgage Clause in the insurance policy. The Insured commenced legal action against Farmers' Mutual seeking to enforce their claim under the policy.

Even though the Insured's action against the Insurer under the policy had not yet been decided, Farmers' Mutual started its own action against the Insureds, relying upon the right of subrogation within the Standard Mortgage Clause, claiming the amount the Insurer had paid to the bank. The Ontario Court of Appeal concluded that it was premature to grant judgment to Farmers' Mutual on a subrogated claim because it had not yet been determined whether the Insureds had a valid claim under the policy against the Insurer. Farmers' Mutual sought leave to appeal that decision to the Supreme Court of Canada but that application for leave to appeal was recently dismissed.

Two Preconditions to Insurer's Right of Subrogation Under Standard Mortgage Clause

It is now clear that there are two preconditions to the Insurer's right of subrogation under the Standard Mortgage Clause:

- first, the Insurer must pay the Mortgagee/Lender a portion of the loss award under the insurance policy; and
- second, the Insurer must establish that it has no liability to the Insured Mortgage (i.e. the Insured Mortgagor has done something to void the insurance policy).

Until both preconditions are satisfied, any attempt by the Insurer to recover from the Insured, the amount



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paid to the Mortgagee/Lender under the Standard Mortgage Clause, will be premature.

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