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COMMENT

THE EFFECT OF THE STANDARD MORTGAGE CLAUSE IN INSURANCE POLICIES

By HARRY P COOPER, JR.*

The social interest in the protection of mortgagees has developed in accordance with changes in the business and economic structure. Mortgages on property of all kinds have become so prevalent and are such a necessity under present economic conditions that the protection of the economic interests of mortgagees has become a very important prob-

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lem.¹ By 1922, one authority states, 60 per cent of the realty in the United States was mortgaged.² To secure this protection, there has been both a growth of insurance covering the mortgagee's interest, and an increase in the measure of protection afforded him.³

Four methods of securing protection have been commonly used:

1. A policy between the insurer and the mortgagee as insured. It is generally recognized by the courts that both the mortgagee and the mortgagor have an insurable interest in the mortgaged property⁴ since "a person has an insurable interest in property when he sustains such relations with respect to it that he has a reasonable expectation, resting on a basis of legal right, of benefit to be derived from its continued existence, or of loss or liability from its destruction."⁵ Although this method affords full protection to the mortgagee, it is seldom used because of the disadvantage to the mortgagee of paying the premiums, and the disadvantage to the insurer in the difficulty of supervising the risk, and because of the possibility of fraudulent collusion between the mortgagor and mortgagee.⁶

2. An assignment of the policy to the mortgagee by the insured mortgagor. By this method the protection of the mortgagee is entirely dependent upon the conduct of the mortgagor, for when an assignment is made without an actual transfer of the subject of the insurance, the validity of the policy depends upon the acts or neglect of the mortgagor. In other words, the mortgagee stands in the position of his mortgagor with respect to the insurance contract.⁷

3. A 'loss-payable clause' in the policy. Under this plan the policy contains an endorsement as follows: "Loss, if any, payable to — mortgagee, as — interest may appear, subject nevertheless to all the conditions of this policy." Under this clause the mortgagee is merely an appointee of the insured mortgagor, and is subject to all the defenses to which the insured would be subject.⁸ Consequently this method has the same disadvantages with respect to the mortgagee as an assignment.

¹ The Standard Mortgage Clause in Fire Insurance Policies (1933), 33 Col. L. Rev. 305-316.

² Bament, *The Fire Insurance Contract* (1922), 199.

³ The Standard Mortgage Clause in Fire Insurance Policies (1933), 33 Col. L. Rev. 305-316.

⁴ Huebner, *Property Insurance* (1928), 49; Vance, *Handbook of Insurance* (1904), 417.

⁵ Vance, *Insurance* (2d. ed., 1930), 124.

⁶ Huebner, *Property Insurance* (1928), 51.

⁷ Huebner, *Property Insurance* (1928), 52.

⁸ Blinkoff, *Rights of Mortgagee Under Standard Mortgage Clause in Insurance Policy* (1934), 17 Cor. L. Q. 151-158; Richards, *Insurance* (3d. ed., 1910), 394.

4. A 'Standard, or Union, mortgage Clause' in the policy. This is now the most commonly used and the best method of protecting the interest of a mortgagee in insured property.⁹ The New York Standard Mortgage Clause is the leading form of the clause and is as follows: "Loss or damage, if any, under this policy, shall be payable to — as — mortgagee (or trustee) as interest may appear, and this insurance, as to the interest of the mortgagee (or trustee) 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 (or trustee) shall on demand pay the same.

"Provided also, that the mortgagee (or trustee) shall notify this company of any change of ownership or occupancy or increase of hazard which shall come to the knowledge of said mortgagee (or trustee) and, unless permitted by this policy, it shall be noted thereon and the mortgagee (or trustee) shall, on demand, pay the premium for such increased hazard for the term of the use thereof; otherwise this policy shall be null and void.

"This company reserves the right to cancel this policy at any time as provided by its terms, but in such case this policy shall continue in force for the benefit only of the mortgagee (or trustee) for ten days after notice to the mortgagee (or trustee) of such cancellation, and shall then cease, and this company shall have the right, on like notice, to cancel this agreement.

"Whenever this company shall pay the mortgagee (or trustee) any sum for loss or damage under this policy and shall claim that, as to the mortgagor or owner, no liability therefor existed, this company shall, to the extent of such payment, be thereupon legally subrogated to all the rights of the party to whom such payment shall be made, under all securities held as collateral to the mortgage debt or may, at its option, pay to the mortgagee (or trustee) the whole principal due or to grow due on the mortgage with interest, and shall thereupon receive a full assignment and transfer of the mortgage and of all such other securities; but no subrogation shall impair the right of the mortgagee (or trustee) to recover the full amount of — claim."¹⁰

⁹ Blinkoff, *Rights of Mortgagee Under Standard Mortgage Clause in Insurance Policy* (1934), 17 *Cor. L. Q.* 151, 158; *The Standard Mortgage Clause in Fire Insurance Policies* (1933), 33 *Col. L. Rev.* 305-316.

¹⁰ *The Standard Mortgage Clause in Fire Insurance Policies* (1933), 33 *Col. L. Rev.* 305-316; Huebner, *Property Insurance* (1928), 53-55.

This clause is, of course, dated, signed by the company, and attached to the policy of the insured mortgagor, thereby becoming a part thereof.¹¹

Much confusion has arisen concerning the effect of the conduct of the mortgagor on the rights of the mortgagee where there is attached to the policy some such clause as the 'loss payable' or 'standard mortgage' clauses, directing payment of the proceeds to the mortgagee. Most of this confusion has grown out of the various decisions involving 'loss payable' clauses and the attempts to apply them to the 'standard mortgage' clause.¹² However, there is a clear distinction between these two clauses and the amount of protection afforded by each. The 'standard mortgage' clause is held to constitute a separate contract for the protection of the mortgagee, whereas no such separate contract exists by reason of the 'loss payable' clause. Under the latter the rights of the mortgagee are entirely dependent upon the conduct of the insured mortgagor, and are subject to the provisions of the mortgagor's policy.¹³ On the other hand, under the 'standard mortgage' clause the mortgagee is provided with almost impregnable safeguards against the forfeiture or diminution of insurance benefits by the act or neglect of the mortgagor by an express provision to that effect therein contained.¹⁴

The legal effect given to the 'standard mortgage' clause by the courts makes the mortgagee independent of the acts or neglect of the mortgagor. This provision is construed to mean that none of the rights of the former can be vitiated by the conduct of the latter.¹⁵ This protection extends not only to fraudulent, or wrongful conduct on the part of the mortgagor, but also to the making of repairs by the mortgagor, the entering of an appraisal agreement by him without the consent of the mortgagee,¹⁶ and to his taking out of additional insurance without the consent of the mortgagee where the mortgage clause provides

¹¹ Huebner, *Property Insurance* (1928), 55.

¹² Vance, *Insurance* (2d. ed., 1930), 656; 10 Wis. L. Rev. 40-53.

¹³ 3 Words and Phrases, 541; *Smith v. Germania Fire Ins. Co. of N. Y.* (1922), 102 Ore. 569, 202 P 1088; *Franklin Insurance Co. v. Wolff* (1899), 23 Ind. App. 549, 54 N. E. 772, 38 A. L. R. 368; *Carlile v. Home Mut. Ins. Assn.* (1934), 254 N. W. 805 (Iowa), (no recovery by mortgagee under loss-payable clause where arson was committed by mortgagor).

¹⁴ Blinkoff, *Rights of Mortgagee Under Standard Mortgage Clause in Insurance Policy* (1934), 17 Cor. L. Q. 151-158; *The Standard Mortgage Clause in Fire Insurance Policies* (1933), 33 Col. L. Rev. 305-316.

¹⁵ *Beaver Falls Bldg. & Loan Assn. v. Allemania Fire Ins. Co.* (1921), 305 Pa. 290, 157 A. 616.

¹⁶ *Saverese v. Ohio Farmer's Ins. Co.* (1932), 260 N. Y. 45, 182 N. E. 665 (repairs by mortgagor); *Payne v. Bankers' & Shippers' Ins. Co. of N. Y.* (1934), 77 S. W. (2d) 183 (Mo.) (Adjustment between mortgagor and insurer without consent of mortgagee).

for contribution.¹⁷ In order to guarantee this protection to the mortgagee, the courts almost universally hold that such a clause constitutes a separate and independent contract of insurance between the insurance company and the mortgagee. Thus, the mortgagee's protection depends only upon his own conduct.¹⁸

Such a clause contemplates the possibility of foreclosure and provides full protection to the mortgagee or his assignee during such foreclosure.¹⁹ The insurer is not entitled to assert against the mortgagee the defenses relating to sole and unconditional ownership interposed against the insured,²⁰ nor, by the weight of authority, any other defenses interposed against the insured.

However, the mortgagee's immunity against defenses raised by the misconduct of the insured mortgagor is recognized universally only where such misconduct takes place subsequently to the issuance of the insurance policy.²¹ In other words, there are two lines of authority concerning the effect of the acts of the mortgagor on the rights of the mortgagee under the 'standard mortgage' clause. Under the majority view the mortgagee is protected against all acts of the mortgagor regardless of whether they occurred prior to, at the time of, or subsequently to the inception of the insurance policy.²² Under the Canadian view and that of a strong minority in the United States the mortgagee is protected only against the acts or neglect of the mortgagor which occur subsequently to the issuance of the policy.²³ The two views arose from a difference in interpretation of the provision

¹⁷ *Eddy v. London Assur. Co.* (1894), 143 N. Y. 311, 38 N. E. 307, Huebner, *Property Insurance* (1928), 61, 62.

¹⁸ *Best's Insurance News* (Aug. 20, 1929), 226, 227, *Syndicate Ins. Co. v. Bohn* (1894), 65 F. 176 (Neb.); *Germania Fire Ins. Co. v. Bailey* (1918), 19 Ariz. 580, 586, 173 P. 1052; *Magoun v. Firemen's Ins. Co.* (1902), 86 Minn. 486, 490, 91 N. W. 5, 7, *Federal Land Bank v. Atlas Assur. Co.* (1924), 188 N. C. 747, 748, 125 S. E. 631, 633; *Goldstein v. Nat. Liberty Ins. Co.* (1931), 256 N. Y. 26, 29, 175 N. E. 359, 360; *Cooley, Briefs on Insurance* (2d. ed., 1927), 1269, 1288, 1988, 1989, 2390; *The Standard Mortgage Clause in Fire Insurance Policies* (1933), 33 Col. L. Rev. 305-316, *Stockton v. Atlantic Fire Ins. Co.* (1934), 207 N. C. 43, 175 S. E. 695, *National Fire Ins. Co. v. Finerty Inv. Co.* (1934), 38 P. (2d) 496 (Okla.).

¹⁹ *National Fire Ins. Co. of Hartford Conn. v. Finerty Inv. Co.* (1934), 38 P. (2d) 496 (Okla.).

²⁰ *Galliotti v. Continental Ins. Co.* (1933), 273 N. Y. S. 29.

²¹ *Blinkoff, Rights of Mortgagee Under Standard Mortgage Clause in Insurance Policy* (1934), 17 Cor. L. Q. 151-158.

²² *Goldstein v. Nat. Liberty Ins. Co. of Am.* (1931), 256 N. Y. 26, 175 N. E. 359; *Syndicate Ins. Co. v. Bohn* (1894), 65 F. 176 (Neb.), *Richards, Insurance* (3d ed., 1910), 394.

²³ *Blinkoff, Rights of Mortgagee Under Standard Mortgage Clause in Insurance Policy* (1934), 17 Cor. L. Q. 152.

in the 'standard mortgage' clause that no act or neglect of the mortgagor shall affect the rights of the mortgagee, and both are based on New York cases.²⁴ By extending the doctrine of the one case, the Hastings case, the majority of the courts of the United States have reached the conclusion that the 'standard mortgage' clause protects the mortgagee against any act of the mortgagor whether committed prior to, at the time of, or subsequently to the inception of the policy of insurance. By extending the doctrine of the other case, the Graham case, the minority have decided that the provision that no act or neglect of the mortgagor shall affect the rights of the mortgagee does not include fraud, misrepresentation, concealment, and other conduct of the mortgagor prior to or at the time of the inception of the policy.²⁵

Although the courts have failed to rationalize the 'standard mortgage' clause and thereby explain and harmonize their holdings, it seems that two factors have been of predominant influence bringing about the decisions now existing. First, the protection of the mortgagee has been uppermost in the minds of the courts in construing the clause.²⁶ Second, as heretofore mentioned, the confusion that arose under the 'loss payable' clause is still present in the law and has no little influence on the interpretation of the 'standard mortgage' clause. To secure the protection intended by the 'standard' clause and to avoid the problems involved by the 'loss payable' clause, the courts seemingly have grasped for two straws of distinction, the idea of an independent contract of insurance between the insurer and the mortgagee, and, in partial support thereof, the provision in the clause that no act or neglect of the mortgagor shall invalidate the interest of the mortgagee.

²⁴ Blinkoff, *Rights of Mortgagee Under Standard Mortgage Clause in Insurance Policy* (1934), 17 *Cor. L. Q.* 153, *Hastings v. Westchester Fire Ins. Co.* (1878), 73 *N. Y.* 141; *Graham v. Firemen's Ins. Co.* (1881), 87 *N. Y.* 69. The majority follows the Hastings case which held that a mortgagee was not bound by a contribution clause in the mortgagor's policy since the procuring of other insurance prior to the attachment of the mortgage clause constituted an act of the mortgagor against which the mortgagee was protected by the protective provision of the mortgage clause. The minority follows the Graham case which held that the mortgagee was not protected against a misrepresentation as to ownership by the insured mortgagor, the court saying, "The clause contemplates a case where the mortgagor could act or neglect and not a case where the policy was issued in the name of an infant, who by reason of incapacity, could not furnish any protection to the company whatever," and saying that such a policy obtained through misrepresentation as to the owner cannot be fairly considered as within the meaning of the clause, nor can it be regarded as an act or neglect within the terms of the policy.

²⁵ Blinkoff, *Rights of Mortgagee Under Standard Mortgage Clause in Insurance Policy* (1934), 17 *Cor. L. Q.* 153, 154.

²⁶ Blinkoff, *Rights of Mortgagee Under Standard Mortgage Clause in Insurance Policy* (1934), 17 *Cor. L. Q.* 157.

Very little, if any, attempt at analysis has been made, the end apparently being considered sufficient justification for the means. Herein lies the problem of interpreting the 'standard mortgage' clause.

The courts have given various reasons for holding the 'standard mortgage' clause to constitute an independent contract between the insurer and the mortgagee, but most of them are insufficient. Some courts have said that the provisions for subrogation,²⁷ or for payment of the premiums by the mortgagee on default of the mortgagor provide consideration,²⁸ but such cannot be the case since these provisions are held to be conditions and not covenants on the part of the mortgagee;²⁹ that being the case, the mortgagee owes no duty to the insurer which would constitute consideration.³⁰ Other courts have said that the promise of the mortgagor amounts to consideration for the contract between the insurer and the mortgagee,³¹ but such cannot be true unless there is an agency relation between the mortgagee and the mortgagor wherein the latter is the agent of the former.³² Further, unless there is an agency relation there can be no offer and acceptance, no privity of contract, between the insurer and the mortgagee since the 'standard mortgage' clause is usually endorsed on the policy at the request of the insured mortgagor.³³ Consequently, the 'standard mortgage' clause does not constitute a contract between the insurer and mortgagee separate and independent from the mortgagor. However, it does constitute a contract of insurance for the mortgagee separate from, and independent of, the contract of insurance for the mortgagor. That is, the mortgage clause is an insurance of the mortgagee's interest for his benefit, and the policy is an insurance of the mortgagor's interest for his benefit. So far as the writer has been able to determine there has been no rationale adopted or suggested by the courts that satisfactorily solves the problems presented by the 'standard mortgage' clause. However, two theories have been suggested at rare intervals which are worthy of mention, namely, that of a third party creditor-beneficiary

²⁷ *Hastings v. Westchester Fire Ins. Co.* (1878), 73 N. Y. 141.

²⁸ *Union Trust Co. v. Philadelphia Fire and Marine Ins. Co.* (1929), 127 Me. 528, 537, 145 A. 243, 248.

²⁹ *Home Ins. Co. v. Union Trust Co.* (1917), 40 R. I. 367, 374, 100 A. 1010, 1012; *Coykendell v. Blackmer* (1914), 161 App. Div. 11, 146 N. Y. S. 631, *Acuff Co. v. Bankers' Trust Co.* (1928), 157 Tenn. 99, 7 S. W. (2d) 52; *Farnsworth v. Riverton Wyoming Co.* (1926), 35 Wyo. 334, 249 P. 555.

³⁰ *The Standard Mortgage Clause in Fire Insurance Policies* (1933), 33 Col. L. Rev. 305-316.

³¹ *Home Ins. Co. v. Union Trust Co.* (1917), 40 R. I. 374, 100 A. 1012.

³² *The Standard Mortgage Clause in Fire Insurance Policies* (1933), 33 Col. L. Rev. 305-316.

³³ *The Standard Mortgage Clause in Fire Insurance Policies* (1933), 33 Col. L. Rev. 305-316.

contract, and that of agency. Under either of these the close relation existing between the mortgagor and the mortgage clause can be distinguished from the similarly close relation existing between him and the insurance policy.

Since the clause is usually attached at the request of the insured mortgagor, it follows that the elements of a third party creditor-beneficiary contract are present.³⁴ "Where a third party is a creditor of the promisee, or has a right against him for some particular performance, the purpose with which the promisee contracts with the promisor may be to induce the latter to pay the debt or otherwise discharge the third party's claims. In such a case performance will directly benefit both the third party (the creditor or claimant) and the promisee."³⁵ This analysis has been suggested, but there seem to be few cases recognizing it.³⁶ On the face of it this seems to be the best rationale for several reasons: In the first place, none of the above objections apply; namely, no consideration moving from the mortgagee to the insurer is necessary since there is no such requirement on the part of a beneficiary under a third party beneficiary contract.³⁷ No agency relation is necessary for the payment of premiums by the mortgagor to constitute consideration since the mortgagor and the insurer are the sole parties under the theory of a third party creditor-beneficiary contract,³⁸ although such relation would be necessary were the mortgagee a party to the contract. By their agreement the parties (insurer and mortgagor) make the promise to pay the premium the consideration for both the contract to insure the mortgagor, and the contract to insure the mortgagee. No offer and acceptance, or privity of contract, is necessary as between the mortgagee and the insurer since they are beneficiary and promissory.³⁹ In the second place, it accounts for the mortgagee's capacity to make a valid assignment of his interests without the consent of the insurer,⁴⁰ and, in the third place, there is no direct

³⁴ *The Standard Mortgage Clause in Fire Insurance Policies* (1933), 33 Col. L. Rev. 307, 308; See, Corbin, *Contracts for the Benefit of Third Persons*, and Williston, *Contracts for the Benefit of a Third Person*, in *Selected Readings in the Law of Contracts* (1931), 648, 652, 653; 619, 628, 629.

³⁵ Anson, *Contracts* (1930), 365.

³⁶ *Walker v. Queen Ins. Co.* (1926), 36 S. C. 144, 162, 134 S. E. 263, 269; *State Bank of Chilton v. Citizens Mutual Fire Ins. Co.* (1934), 252 N. W. 164 (Wis.).

³⁷ Anson, *Contracts* (1930), 369, 374.

³⁸ Anson, *Contracts* (1930), 369.

³⁹ *Lawrence v. Fox* (1859), 20 N. Y. 268, 33 Col. L. Rev. 307.

⁴⁰ 33 Col. L. Rev. 308; *Key v. Continental Ins. Co.* (1903), 101 Mo. App. 344, 77 S. W. 162; *Central Union Bank v. N. Y. Underwriters Ins. Co.* (1931), 52 F. (2d) 825 (S. C.); *The Standard Mortgage Clause in Fire Insurance Policies* (1933), 33 Col. L. Rev. 305-316.

contractual relationship between the insurer and the mortgagee,⁴¹ yet the mortgagee has an enforceable right.⁴² However, there are several grave objections to the third party creditor-beneficiary contract as the rationale of the 'standard mortgage' clause.

On the other hand, it frequently happens as a matter of fact that the mortgagee requests the mortgagor or insurer that the 'standard mortgage' clause be attached to the mortgagor's policy. Invariably the mortgagor knows of such request and assents thereto. Consequently, there can be either an implied or an express agency relation between the mortgagee as principal and the mortgagor as agent. By analyzing the negotiations this way, the mortgage clause constitutes a separate and independent contract of insurance between the mortgagee and the insurer. As to the aforementioned objections to the 'standard mortgage' clause as a separate and independent contract between the insurer and the mortgagee:—first, the consideration is contained in the premium paid by the mortgagor on his policy. By agreement the parties can adopt part thereof as the consideration for the separate contract entered into by the mortgagor as agent for the mortgagee. Second, offer and acceptance, or privity of contract, is secured by means of the agency relation. Thus the 'standard mortgage' clause can constitute a contract between the insurer and the mortgagee, and it is separate and independent from the policy of the mortgagor, for the parties thereto are not the same. However, as in the third party creditor-beneficiary rationale, the contract is not independent and separate from the mortgagor, for as agent he can bind the mortgagee, his principal, by his conduct. If his conduct as and while agent is improper, the separate contract set out in the mortgage clause may be invalid, for the acts of the agent are the acts of the principal. The conduct of the mortgagor with reference to his own policy of insurance alone, of course, has no effect on the mortgage clause contract. With respect to that insurance contract the mortgagor acts, not as the mortgagee's agent, but as the principal party thereto.

Although perhaps the same result can be reached by either theory, and although *prima facie* the problems arising in connection with the 'standard mortgage' clause can be solved by correct application of the principles of either, they are *contra* in one respect. That is, under the third party creditor-beneficiary view, there is no direct contractual relationship between the insurer and the mortgagee, whereas under the agency view, there is a direct contractual relationship between them. However, this conflict is immaterial with regard to the result reached by each theory.

⁴¹ 33 Col. L. Rev. 309; *Central Union Bank v. N. Y. Underwriters Ins. Co.* (1931), 52 F (2d) 825 (S. C.).

⁴² *Anson, Contracts* (1930), 365, *Lawrence v. Fox* (1859), 20 N. Y. 268.

By rationalizing the 'standard mortgage' clause as either a third party creditor-beneficiary contract, or as a separate and independent contract formed by means of agency, the grounds of difference responsible for the split of authority as to the effect of the mortgagor's acts on the rights of the mortgagee when committed (or omitted) prior to or at the time of the inception of the insurance contract are destroyed. The faults of each view are eliminated while the advantages are retained. Under either of such rationales only that conduct on the part of the mortgagor which is directly involved in the formation of the contract of insurance for the benefit of the mortgagee can affect the protection given under the mortgage clause;⁴³ that conduct on the part of the mortgagor which pertains solely to the formation and maintenance of his own policy of insurance can have no effect whatever on the rights of the mortgagee under the 'standard mortgage' clause. In other words, improper conduct on the part of the mortgagor at the inception of and with respect to his policy may render it voidable or invalid, but such conduct has no effect on the mortgage clause unless it was influential in securing the attachment of the clause; that is, unless the misconduct of the mortgagor induced the insurer to promise to perform the contract for the benefit of the mortgagee, which contract is evidenced by the 'standard mortgage' clause, such misconduct has no effect thereon. Thus, as the weight of authority holds, the mortgagee is protected against any acts of the mortgagor whether they occurred prior to, at the time of, or subsequently to the inception of the policy of insurance, but this is true *only* if such acts did not constitute inducement for the formation of the contract set out in the mortgage clause. Also, as the minority holds, fraud, misrepresentation, concealment, or other misconduct prior to or at the time of the inception of the policy render the mortgage clause unenforceable, but *only* when the inception of the mortgage clause contract occurred at the time of the inception of the policy and, being a part of the same transaction, was dependent upon the identical circumstances for its formation. In other words fraud, misrepresentation, concealment, or other misconduct on the part of the mortgagor prior to or at the time of the inception of the *mortgage clause contract* when, and only when, inducive to that contract regardless of and independent from the mortgagor's policy, vitiates the 'standard mortgage' clause.

It goes without saying that under the third party creditor-beneficiary contract rationale that as soon as the right of the mortgagee beneficiary is in existence, it is beyond the power of the mortgagor promisee to destroy such by wrongful conduct that would discharge the promisor's (insurer's) duty to himself.⁴⁴ Under the agency rationale, since the

⁴³ Anson, *Contracts* (1930), 378.

⁴⁴ Anson, *Contracts* (1930), 378.

agency relation between the mortgagee and the mortgagor is only for the purpose of securing the attachment of the mortgage clause, the mortgagor's authority and power to change the legal relations of the mortgagee is terminated when that purpose is accomplished. Consequently the basis for the two lines of authority is destroyed. Under either of these analyses, it seems that the mortgagee is protected, but he, instead of the insurer, bears the risk of the mortgagor's conduct at the inception of the mortgage clause contract.⁴⁵ In other words, the insurer does not assume the mortgagee's risk without a contract to that effect.

Although the correct and desirable result can be reached by either theory, there are serious objections to both the agency and, as heretofore suggested, the third party creditor-beneficiary analyses. The adoption of the former would be a step backwards rather than one forwards. It would indicate a reversion to the old and by no means obsolete habit of categorization, or of 'pigeon holing' new problems into the existing, or so-called static, shelves of the law. The common law practice of fabrication, or resorting to fiction, would of necessity be revived, for there is seldom a clear cut agency relation existing in the creation of the mortgage clause contract. Since the use of this legal excuse or alibi for distorting facts is unnecessary, it seems highly inadvisable to rely upon it. It is true that in some, and perhaps many instances, there is an actual agency relation existing, but it is equally true that in other instances, and perhaps a greater number thereof, there is no actual agency, nor even an intention to create an agency relation. It seems unnecessary to attempt to 'squeeze' this latter class of cases into a theory which fits only the former class.

The adoption of the latter theory, that of the third party creditor-beneficiary contract, is subject, though to a less degree, to the same objection of 'pigeon holing.' The objection is not so strong in this case because the mortgage clause can be correctly interpreted to constitute a third party creditor-beneficiary contract.⁴⁶ However, the principles upon which the 'standard mortgage' clause is based are not synonymous with those supporting the third party creditor-beneficiary contract. The bases of the 'standard mortgage' clause are the protection of the mortgagee and the avoidance of the undesirable consequences of the 'loss payable' clause, as hereinbefore submitted. These principles are universally applicable, whereas some states do not recognize the third party beneficiary contract. Further, such analysis probably could not cover all contingencies without violation of the underlying principles of the mortgage clause. As is said in the Restatement of the Law of Contracts, "* * * if a contract is conditional, voidable, or

⁴⁵ Blinkoff, *Rights of Mortgagee Under Standard Mortgage Clause in Insurance Policy* (1934), Cor. L. Q. 151-158.

⁴⁶ 33 Col. L. Rev. 307-308, Anson, *Contracts* (1930), 365.

unenforceable at the time of its formation, or subsequently ceases to be binding in whole or in part because of impossibility, illegality, or the present or prospective failure of the promisee to perform a return promise which was the consideration for the promisor's promise, the right of a donee beneficiary or a creditor beneficiary under the contract is subject to the same limitation."⁴⁷ By the same authority it is also said, "A discharge of the promisor by the promisee in a contract or a variation thereof by them is effective against a creditor beneficiary if the creditor beneficiary does not bring suit upon the promise or otherwise materially change his position in reliance thereon before he knows of the discharge or variation."⁴⁸ Thus it can be seen that the adoption of the third party beneficiary analysis would necessitate the application of principles not in keeping with the policy exemplified by the 'standard' clause.

Although, so far as the writer has been able to find, there is no direct substantiating authority, it is submitted that the 'standard mortgage' clause can be properly and effectively rationalized under the law of relations. Fundamentally, such clause is merely the definition or expression of a relation. That relation arises and exists only when by force of circumstances the interests of mortgagee, mortgagor, and insurer are placed in such proximity as to constitute a static condition wherein there is a constant interplay of reciprocal claims and duties that give effect to certain incidents recognized by law.

The basic analogy of the law in its formative period, the typical social and legal institution of the time, was the relation of lord and man, the feudal relation. Continual resort to this analogy has made the idea of relation the fundamental concept of our juristic thought. The landlord and tenant relation, domestic relations, the agency relation, the fiduciary relation, the partnership relation, the relation of mortgagor and mortgagee, are but outstanding illustrations of this concept.⁴⁹ The legal and economic importance of the relation between the mortgagee, mortgagor, and insurer, created by the insurance of the separate interests of each of the two former parties under one policy recognizing such separate interests, gave rise to the 'standard mortgage' clause. Neither the progenitors of the clause nor those who have since adopted it had in mind the creation of a third party beneficiary contract or an agency relation. They were intending to formulate the rights and duties incident to the relation in which they found themselves.

Under this relational analysis the 'standard mortgage' clause may be regarded as the standard by which the relation is determined. Its

⁴⁷ A. L. I., Restatement of the Law of Contracts (), 140.

⁴⁸ A. L. I., Restatement of the Law of Contracts (), 143a.

⁴⁹ Pound, Interpretation of Legal History (), 56, 57, 58; Bowman, Handbook of Elementary Law (1929), 300.

endorsement on the policy of the insured is the event by means of which the legal incidents of the relation arise, and by and at the time of which, the parties enter into the legal relation which results. By such rationale the universal holding that the insurances of the respective interests of the mortgagor and the mortgagee are separate and independent is satisfactorily and, it is submitted, correctly explained. The various reasons given by the courts and the objections thereto are inapplicable. The problem of the effect of the mortgagor's acts upon the rights of the mortgagee with respect to whether they occurred prior to, at the time of, or subsequently to the inception of the insurance contract is solved according to the same principle as it would be under either the third party creditor-beneficiary, or the agency rationale hereinbefore set out. That is, two relations are involved, that between the insured mortgagor and the insurer which results from the contract of insurance, and that involving mortgagor, mortgagee, and insurer which results from the endorsement of the 'standard mortgage' clause. Conduct of the mortgagor while he is in the first relation can have no effect upon the rights of the mortgagee after the second relation arises because the mortgagee is not a party to the first relation. Such is the case when the mortgage clause is attached subsequently to the issuance of the policy. With the attachment of the mortgage clause the second relation, a new relation, arises. The incidents attached to the old relation continue and those attached to the new relation are added. Thus the mortgagor can invalidate the insurance as to himself, but not as to the mortgagee. Where the mortgage clause is attached at the time of the issuance of the policy the first relation does not arise, but only the second arises. Were fraud or other misconduct present here, at the time of the creation of the relation it would, of course, defeat the rights of the mortgagee if he were involved in it, as an essential incident of the relation, for the insurer has rights springing from the relation as well as the mortgagee. However, were the mortgagee innocent, there would be a question as to whose rights were superior, the mortgagee's or the insurer's. The same question would arise were fraud involved in the attachment of the clause on an already existing policy. Although there can be no positive rule in this regard under the relational theory as there is under either of the other two theories mentioned, it is possible that in this one instance there might be a greater interest in the protection of the insurer than in the protection of the mortgagee. However, the preponderance of interest would be determined by the circumstances of the case, that is, upon whom should fall the risk of the mortgagor's conduct at the inception of the mortgage clause. If the circumstances indicate this to be a risk of suretyship, the mortgagee should bear it, but if they indicate it to be a risk of insurance, the insurer should bear it.

The fact that there can be no positive rule under the relational analysis is additional reason for its adoption, since it is sufficiently elastic to cover new situations that may arise, and yet sufficiently rigid and constant with respect to normal factual situations to be suitable as precedent for future cases. Further, since the relational incidents are variable according to factual circumstances, the mortgage clause would be subject to judicial policy. In this way the principles behind the mortgage clause could be effectuated with consistency according to the state of social and economic affairs.

Two more problems that frequently arise in connection with the 'standard' clause in insurance policies are those of subrogation and contribution. When there is a loss and payments are made to the mortgagee under the 'standard mortgage' clause, the mortgagor, if the policy is not voided as to him, is entitled to have such payments credited to his mortgage debt. Otherwise there would be double payment to the mortgagee. However, where the insurer contends that the mortgagor has forfeited his protection and no liability exists as to him, the insurer is subrogated to the rights of the mortgagee to the extent of the amount paid him. The 'standard mortgage' clause, as set forth above, generally contains a provision to this effect.⁵⁰ This right to subrogation on the part of the insurer arises not from its mere claim of non-liability to the mortgagor but from the existence of facts invalidating the insurance as to him. Under the 'standard mortgage' clause the mortgagee is entitled to have the mortgage debt paid in full before subrogation. When only the first mortgagee is included in the clause, the insurer, if not liable to the mortgagor, is entitled to subrogation to the rights of the first mortgagee, including priority over a second mortgagee.⁵¹

Where the mortgagor has several policies of insurance on his property, and only one or a few of them have a 'standard mortgage' clause endorsed thereon, the problem often arises whether the various insurers are liable only for their proportion of the loss, or whether the mortgagee can collect the entire amount of the loss from the insurer that issued the mortgage clause. Where there is a contribution clause in the policy (a provision for apportionment of the loss) such clause has no effect upon a 'standard mortgage' clause.⁵² Because of this general holding, which is based upon the theory that the 'standard' clause is an independent insurance of the mortgagee's interest, a contribution clause is often inserted in the mortgage clause itself. This clause is as follows: "In case of any other insurance upon the within described property this company shall not be liable under this policy for a greater propor-

⁵⁰ 52 A. L. R. 278 (Anno.), *Insurance Co. of North America v. Martin* (1898), 151 Ind. 209, 51 N. E. 361.

⁵¹ (1934), 19 Minn. L. Rev. 125, 126.

⁵² Huebner, *Property Insurance* (1928), 60; *Hastings v. Westchester Fire Insurance Co.* (1878), 73 N. Y. 141.

tion of any loss or damage sustained than the sum hereby insured bears to the whole amount of insurance on said property, issued to or held by any party or parties having an insurable interest therein, whether as owner, mortgagee, or otherwise." A 'standard mortgage' clause containing this added clause is called a 'full contribution mortgage clause', whereas one without the added clause is called a 'non-contribution mortgage clause'.

There are two lines of authority with respect to the interpretation of the 'full contribution' clause. The majority holds that the contribution clause is inconsistent with that section of the 'standard' clause which protects the mortgagee against any act or neglect of the mortgagor, especially where the additional insurance is taken out by the mortgagor subsequently to the endorsement of the mortgage clause and without the knowledge or consent of the mortgagee. In such case to give effect to the contribution clause would be to permit the mortgagor, by his act of securing additional insurance, to reduce the amount recoverable by the mortgagee and thereby reduce his protection.⁵³ The minority hold that the contribution clause is a limitation on the general provision for the mortgagee's protection,⁵⁴ and therefore effectuate it. True, securing additional insurance would prejudice the mortgagee's rights and protection under the 'standard mortgage' clause if such act could legally have any effect thereon. It is also true that in a contract parties may specify and limit their obligations thereunder. Consequently there is a conflict.

By rationalizing the 'standard mortgage' clause under the relational concept a result that is fair and in accord with the principles underlying the mortgage clause can be reached in this instance. Where there is a contribution clause involved, the ordinary mortgage clause relation is changed thereby to the extent of the provisions therein contained. Upon entering the relation the mortgagee accepts the incidents thereof; consequently, if facts upon which the contribution clause operates exist at that time, the mortgagee subjects his rights as they exist under the ordinary relation to the limitation imposed by this relation. The mortgagee is protected, but again the risk of the mortgagor's conduct prior to the commencement of the relation is upon him rather than the insurer. Further, he can demand a non-contribution clause, or get other insurance if he is unwilling to become a party to such relation. However, if the facts upon which the contribution clause operates do not exist at the time the 'full contribution' mortgage clause relation is entered into, the relation is synonymous

⁵³ Huebner, *Property Insurance* (1928), 62; *Eddy v. London Assur. Co.* (1894), 143 N. Y. 311, 38 N. E. 307, *Bennett v. Provident Fire Insurance Co.* (1930), 198 N. C. 174, 151 S. E. 98.

⁵⁴ Huebner, *Property Insurance* (1928), 62; *Federal Land Bank v. Globe and Rutgers Fire Insurance Co.* (1924), 187 N. C. 97, 121 S. E. 37.

with the normal 'standard mortgage' clause relation, for it is in accord with the basic principles of the relation to give greater effect to the provision of the mortgage clause guaranteeing the mortgagee protection against the acts or neglect of the mortgagor, than to the provision for contribution. Further, it is submitted that the rights of the insurer should and could be protected under the relational analysis. Under this relation it is improper for the mortgagor to take out additional insurance because to do so would necessarily infringe upon either the rights of the mortgagee or those of the insurer. As the protection of the mortgagee is the main purpose of the mortgage clause his rights are preserved inviolate; as the addition of the contribution clause to the mortgage clause is to limit the insurer's liability, his rights ought to be protected too. This could be accomplished by subrogating the insurer to the rights of the mortgagee against the mortgagor to the amount of the excess payment under the contribution clause. Thus, only the one violating the obligations of the relation would be injured.

In Indiana there is no judicial authority as to the legal effect of the 'standard mortgage' clause in insurance policies. There are no cases directly in point that have been decided by the Indiana courts, and in but one case is there any dictum on the subject. In that case, *Insurance Co. of North America v. Martin*,⁵⁵ the court said, "There is no question in view of the well settled principles of insurance law, but what the mortgage clause in the case at bar constituted a contract between the insurer and the mortgagee. By this contract the terms and conditions of the policy relative to the neglect of the mortgagor or owner of the property, and the prohibition against alienation thereof, etc., were modified, and the mortgagee was thereby removed beyond the effect or control of these stipulations and conditions." With respect to the effect of the time of the commission of the mortgagor's acts, that is, whether before or after the inception of the policy, and with respect to the analysis of the 'standard mortgage' and the 'full contribution' clause, Indiana has as yet taken no position. The *Martin* case, mentioned above, dealt with subrogation and allowed such, but that is as close to the subject of the 'standard mortgage' clause as any Indiana case has come. This dearth of adjudication leaves a field unmarred by the judicial strife that attended this phase of the law in some of our sister states.⁵⁶ Hence, it may be confidently hoped that the courts of this state, by heeding the experience of other jurisdictions, social and economic conditions, and their application to the mortgage clause relation, will develop a clear and accurate state of the law concerning the effect of the 'standard mortgage' clause in insurance policies.

⁵⁵ (1898), 151 Ind. 209, 51 N. E. 361.

⁵⁶ 10 Wis. L. Rev. 40-53.