Case Name:

Pinder v. Farmers' Mutual Insurance Co. (Lindsay)

Between
Farmers' Mutual Insurance Company (Lindsay), Plaintiff (Respondent), and
Cindy Pinder and Joyce Pinder, Defendants (Appellants)

[2009] O.J. No. 4964

2009 ONCA 831

313 D.L.R. (4th) 482

[2010] I.L.R. I-4920

87 R.P.R. (4th) 1

80 C.C.L.I. (4th) 161

2009 CarswellOnt 7386

Docket: C50174

Ontario Court of Appeal
Toronto, Ontario

D.R. O'Connor A.C.J.O., R.A. Blair and R.G. Juriansz JJ.A.

Heard: September 11, 2009.
Judgment: November 26, 2009.

(43 paras.)

Insurance law -- Subrogation -- Effect of -- On rights of action -- Appeal by plaintiff insured from order granting Insurer summary judgment against them allowed and judgment set aside -- Insurer's application for summary judgment dismissed -- Plaintiffs' application that Insurer's action be consolidated or heard together with their action allowed -- Insurer had denied plaintiff's coverage on fire insurance policy but paid Bank under standard mortgage clause -- Insurer then brought action against plaintiffs relying on its right of subrogation -- There were two preconditions to Insurer's

entitlement to subrogation; the Insurer had to make payment of loss award, or part of it, to mortgagee, and Insurer had to establish claim that it had no liability to mortgagor insured -- The existence of the second precondition constituted a genuine issue for trial.

Insurance law -- Actions -- Practice and procedure -- Joinder and consolidation -- Appeal by plaintiff insured from order granting Insurer summary judgment against them allowed and judgment set aside -- Insurer's application for summary judgment dismissed -- Plaintiffs' application that Insurer's action be consolidated or heard together with their action allowed -- Insurer had denied plaintiff's coverage on fire insurance policy but paid Bank under standard mortgage clause -- Insurer then brought action against plaintiffs relying on its right of subrogation -- There were two preconditions to Insurer's entitlement to subrogation; the Insurer had to make payment of loss award, or part of it, to mortgagee, and Insurer had to establish claim that it had no liability to mortgagor insured -- The existence of the second precondition constituted a genuine issue for trial.

Insurance law -- Fire insurance -- Loss payable to mortgagee -- Appeal by plaintiff insured from order granting Insurer summary judgment against them allowed and judgment set aside -- Insurer's application for summary judgment dismissed -- Plaintiffs' application that Insurer's action be consolidated or heard together with their action allowed -- Insurer had denied plaintiff's coverage on fire insurance policy but paid Bank under standard mortgage clause -- Insurer then brought action against plaintiffs relying on its right of subrogation -- There were two preconditions to Insurer's entitlement to subrogation; the Insurer had to make payment of loss award, or part of it, to mortgagee, and Insurer had to establish claim that it had no liability to mortgagor insured -- The existence of the second precondition constituted a genuine issue for trial.

Appeal by the Pinders from an order granting the insurer, Farmers' Mutual, summary judgment against them. On February 2, 2004, there was a fire at the Pinders' home. On March 29, 2004, the Pinders submitted a claim to the insurer for $302,412 for repairs to the house, damage to contents, and additional living expenses. The insurer denied their claim on the grounds that the Pinders voided their policy by failing to notify the insurer of a material change in the risk, namely a change in the heating system of the premises, and that the Pinders made wilfully false statements with respect to their contents claim and their claim for alternate living expenses, thus vitiating their right to recover. On July 21, 2004, the Bank of Montreal submitted a proof of loss seeking payment of the mortgage under the standard mortgage clause of the policy in the amount of $99,293. On October 7, 2004, the insurer paid the bank the principal balance of $97,143. On February 1, 2005 the Pinders brought an action against the insurer for a declaration that the insurance policy was valid and binding. On December 18, 2006, the insurer brought an action against the Pinders, relying on its right of subrogation under the standard mortgage clause. The insurer claimed from the Pinders the $97,143 that it had paid the bank on the mortgage. In their defence the Pinders pleaded that the standard mortgage clause was only triggered by the insurer's not being liable to the Pinders for the fire loss. The Pinders counterclaimed for a declaration that the policy remained in full force and effect on the date of the loss, that the insurer was liable to them pursuant to that policy, and that the insurer was not entitled to recover from them any amount it had paid to the bank. In July 2007 the insurer brought a motion for summary judgment in its action against the Pinders. The Pinders then brought a motion for consolidation of the two actions. The motion judge granted summary judgment against the Pinders and stayed the Pinders' counterclaim, thus declining to order that the two actions be consolidated or heard together. At issue on appeal was whether the subrogation right of an insurer un-

der the standard mortgage clause in an insurance policy could be exercised simply upon the insurer paying the loss award to the mortgagee, without the insurer establishing that it had no liability to the insured.

HELD: Appeal allowed and judgment set aside. The insurer's application for summary judgment was dismissed. The Pinders' motion that the insurer's action be consolidated or heard together with their action was allowed. There were two preconditions to the insurer's entitlement to subrogation under the standard mortgage clause. First, the insurer had to make payment of the loss award, or part of it, to the mortgagee. Second, the insurer had to establish that it had no liability to the mortgagor insured. The existence of the second precondition was a genuine issue for trial. In its statement of claim, the insurer pleaded that it denied the Pinders' claim on the basis that their failure to report a material change in risk voided the contract, and alternatively that they had made wilful false statements with respect to their contents claim, issued in their right to recover under the policy. In their statement of defence the Pinders pleaded that the insurer's right under the standard mortgage clause was only triggered by the insurer's not being liable to the Pinders for the fire loss. They also pleaded that they had not breached the insurance contract, the insurance policy remained in full force and effect, and the insurer remained liable to them for payment of the fire loss. The issue raised and joined in the pleadings was a genuine issue for trial. The motion judge erred by granting summary judgment.

Appeal From:

On appeal from the judgment of the Honourable Madam Justice J.E. Ferguson of the Superior Court of Justice dated February 6, 2009 pronounced in Peterborough, Ontario.

Counsel:

J. Paul Dillon, for the appellants.

Martin Forget, for the respondent.

[Editor's note: A correction was released by the Court November 27, 2009; the corrections have been made to the text and the correction is appended to this document.]

The judgment of the Court was delivered by

1 R.G. JURIANSZ J.A.:-- This appeal raises the question of whether the subrogation right of an insurer under the Standard Mortgage Clause in an insurance policy may be exercised simply upon the insurer paying the loss award to the mortgagee without the insurer establishing that it has no liability to the insured.

2 I conclude there are two preconditions to the insurer's entitlement to subrogation under the Standard Mortgage Clause. First, the insurer must make payment of the loss award, or part of it, to the mortgagee. Second, the insurer must establish a claim that it has no liability to the mortgagor insured. This conclusion flows from the construction of the Standard Mortgage Clause and is not dependent on the specific facts of this case.

Facts

3 On February 2, 2004, there was a fire at the home of the appellants, Joyce and Cindy Pinder. The Pinders jointly held a policy of insurance with the respondent, Farmers' Mutual Insurance Company (Lindsay) ("Farmers' Mutual"). The house was owned solely by Joyce Pinder and was subject to a five-year mortgage with the Bank of Montreal for the principal amount of $106,344 with a maturity date of August 1, 2004.

4 On March 29, 2004, the Pinders submitted a claim to Farmers' Mutual seeking $302,412 for repairs to the house, damage to their contents and additional living expenses. Farmers' Mutual denied their claim on May 27, 2004 on two grounds. The first ground was that the Pinders voided the policy by failing to notify the insurer of a material change in the risk, namely a change in the heating system of the premises. The second ground was that the Pinders had made wilfully false statements with respect to their contents claim and their claim for alternate living expenses, thus vitiating their right to recover.

5 On July 21, 2004, the Bank of Montreal submitted a proof of loss seeking payment of the mortgage under the Standard Mortgage Clause of the policy in the amount of $99,293.09. On October 7, 2004, Farmers' Mutual, taking the position that interest, penalties and discharge fees were not covered by the policy, paid the Bank the principal balance only, of $97,143.97.

6 On February 1, 2005 the Pinders commenced an action against Farmers' Mutual seeking a declaration that the insurance policy was valid and binding. That action is as yet to be tried.

7 Farmers' Mutual commenced this action on December 18, 2006, relying on its right of subrogation under the Standard of Mortgage Clause. Farmers' Mutual's action is on the covenant in the mortgage. It claims from the Pinders the sum of $97,143.97 that it paid the Bank on the mortgage. In their defence, the Pinders pleaded that the Standard Mortgage Clause "is only triggered by Farmers' Mutual not being liable to the Pinders for the fire loss." The Pinders, counterclaimed for a declaration that the policy of insurance remained in full force and effect on the date of the loss, that Farmers' Mutual was liable to them pursuant to that policy, and that Farmers' Mutual was not entitled to recover from them any amount it paid to the Bank of Montreal.

8 In July 2007, Farmers' Mutual brought a motion for summary judgment in its action against the Pinders. In response, the Pinders brought a motion for the consolidation of the two actions. Before the motion judge, the Pinders argued that whether the policy is void or not, and whether they have an available remedy of relief from forfeiture were genuine issues for trial. Those questions, the motion judge said, are the exact issues to be determined in the Pinders' action against Farmers' Mutual. In her view, Farmers' Mutual's summary judgment motion in this action was based only on the mortgage with the Bank, the payout to the Bank, and the Standard Mortgage Clause.

9 The motion judge relied upon *CIBC Mortgage Corporation v. Harding* [1993] O.J. No. 603 (General Division) and *7895 Transmere Drive Management Inc. v. Helter Investments Ltd.* [2005] O.J. No. 2847 (S.C.J.) for the proposition that "even when the defendant in a mortgage action asserts a claim that the Plaintiff has breached its duty of care (for which there is a genuine issue for trial), if the Standard Mortgage Clause is applicable, there is no defence in respect of the monies owing under the mortgage and summary judgment is granted accordingly." She added it was well established that the Standard Mortgage Clause in an insurance policy creates an independent contract between the insurer and the mortgagee, such that a mortgagee's interest is not invalidated by any act or neglect by the insured mortgagor." She also stated that *Halifax Insurance Company v. Killick* [2000] N.S.J. No. 272 (N.S.S.C.) "clearly establishes that an insurer is entitled to judgment

against an insured for the monies paid to a mortgagee pursuant to a Standard Mortgage Clause, even if the insured's claim was denied on the basis of a material change in risk. When the insurer has paid the mortgagee it is entitled to judgment against the insured for the amount paid to the mortgagee."

10 Thereupon, the motion judge granted summary judgment against the Pinders in the amount of $97,143.97 plus prejudgment interest. As the Pinders' counterclaim mirrored the claim in their action against Farmers' Mutual, she stayed their counterclaim in this action, thus declining to order that the two actions be consolidated or heard together.

11 The Pinders appeal seeking an order dismissing Farmers' Mutual's motion for summary judgment and an order directing that the two actions be tried together.

Issue

12 The issue on appeal is whether the trial judge erred by finding there were no genuine issues for trial and granting the insurer summary judgment based on its claimed right of subrogation under the Standard Mortgage Clause. In particular, is the payment by the insurer to the mortgagee of any part of the loss award under the insurance policy the sole precondition for the insurer to claim a right of subrogation under the Standard Mortgage Clause?

Analysis

13 None of the cases relied on by the motion judge are helpful in deciding when an insurer can exercise its right of subrogation under the Standard Mortgage Clause without establishing that the policy is void as far as the insured is concerned. The cases *CIBC Mortgage Corporation* and *7895 Transmere Drive* do not involve the subrogated rights of an insurer under the Standard Mortgage Clause at all. *Halifax Insurance Company* did involve the insurer's right of subrogation but did not deal with the situation in this case. In *Halifax Insurance Company*, the insurer paid the mortgagee and then obtained judgment against the insured by exercising its subrogated right. However, it had established at trial that the insurance policy had been voided by a material change in risk. The court in *Halifax Insurance Company* did not consider the appellant's position in this case, that is, that the insurer cannot exercise its subrogated rights without first establishing that the policy has been voided.

14 When the insurer's right to subrogate arises, of course, depends on the language of the Standard Mortgage Clause. Before turning to a close reading of that language, it is useful to begin with a general survey of the function and effect of the Clause within the policy.

15 The Standard Mortgage Clause has been a standard part of insurance policies for well over a century. In *Guerin v. Manchester*, (1898), 29 S.C.R. 139, the Supreme Court of Canada observed that the Clause "appears ... to have been introduced into policies of insurance in the United States of America by the Mutual Insurance Company of New York, in the year 1860".

16 In *Caisse populaire des deux rives v. Société mutuelle d'assurance contre l'incendie de la vallée du richelieu,* [1990] 2 S.C.R. 995, L'Heureux-Dubé J., writing for the unanimous Supreme Court of Canada, found the Standard Mortgage Clause, though part of the policy between the insurer and insured, constitutes a second and separate insurance contract between the insured and the mortgagee. It is worth noting that she reached this conclusion because it "is consistent with the general scheme of insurance law as it is practised in North America, as well as being in keeping with the rules of Quebec civil law as a whole": at para. 18. She stressed that "the development of insurance law must necessarily take place within its own particular socio-economic context, namely

North American insurance practice": at para. 17. Later in these reasons, I will review American insurance law as it bears on the situation in this case.

17 The two contract theory, firmly embedded in North American insurance practice, protects the mortgagee's interest in the insured property even when the insured has done something to void the policy. The separate contract between the insurer and the mortgagee remains in force even when the policy itself has been voided by an act, neglect, omission or misrepresentation attributable to the mortgagor, owner or occupant of the property. Thus, when the insured mortgagor voids the policy, for example, by doing something that materially changes the risk, the Standard Mortgage Clause protects the mortgagee by maintaining the insurance of the mortgagee's interest in force. The insurer must pay the mortgagee's loss to the extent of the policy limits even when the mortgagor insured has voided the policy.

The Standard Mortgage Clause

18 The Standard Mortgage Clause, as approved by the Insurance Bureau of Canada, has two parts:

> IT IS HEREBY PROVIDED AND AGREED THAT:
>
> 1. BREACH OF CONDITIONS BY MORTGAGOR, OWNER OR OCCUPANT
>
> > This insurance and every documented renewal thereof - AS TO THE INTEREST OF THE MORTGAGEE ONLY THEREIN - is and shall be in force notwithstanding any act, neglect, omission or misrepresentation attributable to the mortgagor, owner or occupant of the property insured, including transfer of interest, any vacancy or non-occupancy, or the occupation of the property for purposes more hazardous than specified in the description of the risk;
> >
> > PROVIDED ALWAYS that the mortgagee shall notify forthwith the Insurer (if known) of any vacancy or non-occupancy extending beyond thirty (30) consecutive days, or of any transfer of interest or increased hazard THAT SHALL COME TO HIS KNOWLEDGE; and that every increase of hazard (not permitted by the policy) shall be paid for by the Mortgagee - on reasonable demand - from the date such hazard existed, according to the established scale of rates for the acceptance of such increased hazard, during the continuance of this insurance.
>
> 2. RIGHT OF SUBROGATION
>
> > Whenever the Insurer pays the Mortgagee any loss award under this policy and claims that - as to the Mortgagor or Owner - no liability therefor existed, it shall be legally subrogated to all rights of the Mortgagee against the Insured; but any subrogation shall be limited to the amount of such loss payment and shall be subordinate and subject to the basic right of the Mortgagee to recover the full amount of its mortgage equity and in priority to the Insurer; or the Insurer may at its option pay the Mortgagee all amounts due or to become due under the mortgage or on the security thereof, and shall thereupon receive a full assignment and transfer of the mortgage together with all securities held as collateral to the mortgage debt.

...

> SUBJECT TO THE TERMS OF THIS MORTGAGE CLAUSE (and these shall supersede any policy provision in conflict therewith BUT ONLY AS TO THE INTEREST OF THE MORTGAGEE), loss under this policy is made payable to the Mortgagee.

19 The first part of the Clause contains the language that provides that the policy remains in force as to the interest of the mortgagee despite any act, omission or misrepresentation of the mortgagor or any change in use that increases the risk. This part of the Clause is not at issue in this case. In fact this part of the Clause has been given effect - the insurer has paid the mortgagee the principal balance owing on the mortgage.

20 This case turns on the meaning of the second part of the Clause. The second part of the Clause provides that when its requirements are met, the insurer becomes legally subrogated to all the rights of the mortgagee against the insured to the extent of the payment it has made to the mortgagee.

21 Counsel for the insurer says the Clause provides that the insurer's payment of the mortgage debt to the mortgagee is the only precondition for the insurer's right of subrogation. He submits that as soon as the insurer pays the mortgagee, it is subrogated to the mortgagee's rights under the mortgage to the extent of the payment. Nothing else is required. According to him, the insurer's right of subrogation is unaffected by the phrase "and claims that - as to the Mortgagor or Owner - no liability therefor existed". In fact, he asserts this phrase could be removed without affecting the insurer's right of subrogation. The clause should be read, he says, to provide "Whenever the Insurer pays the Mortgagee, any loss award under this policy, it shall be legally subrogated to all rights of the Mortgagee against the Insured".

22 The phrase "and claims that - as to the Mortgagor or Owner - no liability therefor existed" is part of the Clause and must be given meaning. Counsel for the insurer suggests that the phrase is included to give the insurer a right of subrogation in circumstances where it is liable to the mortgagee quite apart from the Standard Mortgage Clause. He frankly concedes, however, that he cannot give an example of how such a situation would arise. Yet, he submits, this interpretation is necessary to avoid a windfall to the insured where the insurer pays the balance of the mortgage to the mortgagee and pays the insured the loss under the policy as well.

23 The construction the insurer advocates is plainly inconsistent with the language of the Clause. The language of the Clause clearly stipulates two preconditions, not one, to the insurer's right of subrogation. The first precondition is that the insurer pays the mortgagee a portion of the loss award under the policy. The second precondition, following the word "and", is that the insurer claims that it is not liable to the mortgagor or owner for the portion of the loss award it has paid to the mortgagee. The grammatical structure of the Clause excludes interpreting the two phrases as addressing different situations, as the insurer submits. Rather, the two phrases together define what gives rise to the insurer's right of subrogation. The interpretation the insurer puts forward is not only incompatible with the language of the Clause, but also, as I discuss later in these reasons, is inconsistent with how that language has been applied in the North American insurance industry for decades.

24 I turn next to a closer examination of the two preconditions. The first precondition is straightforward. The insurer must pay the loss award, or a portion of it, to the mortgagee. Rarely will there

be a dispute as to whether the insurer has paid any of the loss award to the mortgagee. It is worth noting, however, that the payment the insurer makes to the mortgagee for the purposes of this Clause is the "loss award under this policy".

25 By contrast, the meaning of the second precondition requires closer scrutiny. Read literally, the second precondition could mean that, having made a payment to the mortgagee, the insurer's right of subrogation would be triggered by the mere articulation of a claim that it is had no liability to the mortgagor or owner for the loss award under the policy. Such a meaning would seem inconsistent with the insurance policy considered as a whole within its commercial context. The insured has paid premiums to the insurer for an insurance policy that includes the Standard Mortgage Clause. The Standard Mortgage Clause is for the benefit of the insured as well as the mortgagee. The payment the insurer makes to the mortgagee under the Clause is a part of the "loss award under this policy". Thus, as long as the policy remains in force, the insurer's payment to the mortgagee would be a fulfillment of its obligations to the insured just as much as to the mortgagee. It is unreasonable and contrary to ordinary commercial sense that one party to a contract should be able to negate the bargain made by the other party by articulating nothing more than a bare claim that the insured has voided the contract. It seems to me this is one of those situations Estey J. had in mind when he said in *Consolidated Bathurst Export Ltd. v. Mutual Boiler & Machinery Insurance Co.* [1980] 1 S.C.R. 888, that there were circumstances in which it was inappropriate to apply the literal meaning of an insurance contract. His statement is at para. 26:

> Even apart from the doctrine of contra proferentem as it may be applied in the construction of contracts, the normal rules of construction lead a court to search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract. Consequently, literal meaning should not be applied where to do so would bring about an unrealistic result or a result which would not be contemplated in the commercial atmosphere in which the insurance was contracted. Where words may bear two constructions, the more reasonable one, that which produces a fair result, must certainly be taken as the interpretation which would promote the intention of the parties. Similarly, an interpretation which defeats the intentions of the parties and their objective in entering into the commercial transaction in the first place should be discarded in favour of an interpretation of the policy which promotes a sensible commercial result. It is trite to observe that an interpretation of an ambiguous contractual provision which would render the endeavour on the part of the insured to obtain insurance protection nugatory, should be avoided. Said another way, the courts should be loath to support a construction which would either enable the insurer to pocket the premium without risk or the insured to achieve a recovery which could neither be sensibly sought nor anticipated at the time of the contract. [Emphasis added].

26 Considering the commercial atmosphere in which insurance is contracted, and avoiding a construction which would render nugatory the insurance coverage the insured mortgagor has purchased to cover the mortgage debt, the second precondition in the Clause should be interpreted to require that the insurer establish a claim that the insured mortgagor has voided the policy.

27 This was the view taken by this court more than a century ago in *Bull v. The North British Canadian Investment Company* (1888) 15 O.A.R. 421. The operative part of the mortgage clause in that case provided:

> And it is further agreed that whenever the Company shall pay the mortgagee any sum for loss under this policy, and shall claim that as to the mortgagor or owner no liability therefor existed, said company shall at once be legally subrogated to all the rights of the mortgagee

28 The wording of the clause before the court in *Bull*, given the inclusion of the words "at once", could even be seen to be more favourable to the insurer then the clause in the case presently before the court. Nevertheless, Burton J.A. said at p. 423-424:

> ... the right, therefore, of the insurance company to be subrogated to the rights of the mortgagee must depend upon whether they had or had not a good defence against the mortgagor, the person in whose name the insurance was effected. If they had a good defence, the money paid to the mortgagees would be so paid by reason of the agreement and that alone, if they had not, the money paid would necessarily go in discharge of the mortgage, as the policy was effected for the mortgagors benefit and at his expense.

29 Osler J.A. added at p. 427:

> The insurance company contends that as against the mortgagor they were not liable to pay the loss, and therefore claim to be subrogated to the mortgagees' right under the mortgage at the time they paid it, pursuant to the subrogation clause in the policy.
>
> The plaintiff is entitled to relief unless the insurance company can shew that, as between themselves and the mortgagor, some valid defence existed against his claim on the policy.

30 Hagarty C.J.O. and Patterson J.A. concurred in the result. Thus, having made a payment to the mortgagee, the insurer's right of subrogation is not triggered by the mere articulation of a claim that it is has no liability to the mortgagor or owner for the loss award under the policy.

31 In the one hundred and twenty years following this decision, there has been no further judicial consideration of the issue in Canada. However, this approach to the language of the Standard Mortgage Clause has been applied throughout the North American insurance industry for decades. As noted above, l'Heureux-Dubé J. in *Caisse populaire des deux rives* highlighted the importance of choosing an interpretation of the Standard Mortgage Clause that is consistent with the general scheme of insurance law as it is practised in North America. The Supreme Court also extensively considered American insurance jurisprudence in *National Bank of Greece (Canada) v. Katsikonouris* [1990] 2 S.C.R. 1029. In fact, La Forest J. writing for the majority, in rationalizing his conclusion said at para. 20:

> It is true that the clause under consideration here differs somewhat from that which was the object of consideration in the American decisions. But when one

> looks to the substance of the differences, I conclude that they, if anything, only reinforce the case for adopting the interpretation of the standard mortgage clause advanced in the overwhelming majority of the American decisions.

32 Given the importance of consistency with the general scheme of North American insurance law, it is essential to examine the American jurisprudence on the entitlement of the insurer to subrogation under language such as that of the Standard Mortgage Clause. A useful place to begin that examination is *Couch on Insurance 3d,* looseleaf (St. Paul, Minn.: Thomson West, 1995) ("Couch"), the comprehensive American text on insurance law, cited by our Supreme Court in both *Caisse populaire des deux rives* and *Katsikonouris*. Couch states at s. 224:28:

> The denial of liability to the mortgagor, which is essential to the insurer's right to subrogation to the claim of the mortgagee against the mortgagor, must have a reasonable basis, or as is sometimes stated, must be founded on a legal right. Otherwise stated, the right of the insurer to subrogation to the rights of the mortgagee, upon payment to the latter of the loss under the policy, depends upon the validity and bona fides of its claim of nonliability to the mortgagor; a mere naked claim is insufficient, it must be based on a legal right. [Emphasis added]

33 The footnote supporting this statement (footnote 11) cites cases going back to 1908.[1] The footnote contains the additional statement:

> Right of insurer to subrogation to the rights of the mortgagee upon payment to latter of loss under fire policy did not vest upon mere assertion of claim, unfounded in fact, but could vest only upon valid and well-founded claim of nonliability to mortgagor; the right to subrogation under standard mortgage clause arises only if insurer by payment the mortgagee also discharges its obligation owed to mortgagor under the policy. Southern Tier Co-op Ins. Co. v. Coon, 53 A.D. 2d 970, 385 N.Y.S. 2d 830 (3d Dep't 1976).

34 The first case cited in the footnote is the 1919 decision, *Cronenwett v. Dubuque Fire & Marine Ins. Co.*, 44 Cal. App. 568, 186 P. 826 (1st Dist. 1919). In that case, the Court of Appeal of California said:

> The appellants [the insurers] state that they have at all times claimed, and now claim, that there was no liability to the mortgagor and, therefore, should be subrogated to the interest of the mortgagee. We think the clause above quoted only applies to a claim supported by legal right. It is quite immaterial what the company may claim so long as it be decided by the court that such claim is not founded upon legal rights.

35 Not included in the Couch footnote is the much-cited 1892 decision of the Illinois Supreme Court, *Traders' Ins. Co. v. Race* (1892), 142 Ill. 338, 31 N.E. 392. There the court said:

> The right to subrogation, however, cannot be said to depend upon the naked claim of appellants that there is no liability on the policies to appellee, but the facts must warrant such claim. The claim, to entitle them to an assignment and subrogation, must be made in good faith, and be based upon a state of facts

> which, under the contract of insurance, would entitle them to exemption from liability.

36 The Supreme Court of New York reached the same conclusion in *O'Neil v. Franklin Fire Ins. Co.*, 159 App. Div 313, 145 N.Y.S. 432, affirmed 216 N.Y. 692, 110 N.E. 1045.

37 A commentator relied on by the Supreme Court of Canada in *Caisse populaire des deux rives* has also addressed the question. In "When Is Money Paid the Mortgagee Recoverable? -- Is the Counterclaim Compulsory?" (1986), 22 Tort & Ins. L.J. 113, W. Thompson Comerford Jr. explains that "the basic steps giving rise to the insurer's subrogation under a standard mortgage clause are establishment of nonliability to the mortgagor and payment to the mortgagee." He observes that "[t]he standard clause premises subrogation on a 'claim that to the mortgagor or owner no liability therefor existed'". He goes on to explain that while cases have differed in the burden placed on the insurer to satisfy the requirement a "claim" of non-liability, "[a]t a minimum, the insurer must at some point do more than merely 'claim' nonliability." After reviewing illustrative cases, Comerford comments:

> Although these decisions have been viewed as overly harsh to the insurer, it is difficult to dispute the position that the insurer should not recover amounts paid to the mortgagee unless it can prove that the mortgagor violated the policy terms, despite policy language which appears to place little by way of burden of proof on the insurer. [Footnote omitted]

38 The stability of approach in American insurance jurisprudence is made apparent by a recent synopsis of this longstanding legal principle: Daniel W. Gerber and Nikia A. O'Neal, "Mortgage Clause Claims in the Subprime Fallout" 75 Def. Counsel J. 254 2008. The authors' discussion of the subrogation provision of the New York standard mortgage clause does not differ from the one before us in any material way:

> Importantly, an insurer is not entitled to subrogation or an assignment of the mortgagee's rights, unless the insurer establishes that it has no liability to the named insured mortgagor due to the mortgagor's breach of the insurance contract. This is the rule because so long as the insurer has an obligation to the mortgagor, as well as the mortgagee, the mortgagor has the right to have the insurer's payment to the mortgagee applied to reduce the amount of its mortgage debt. And, the insurer cannot extinguish the mortgagor's right to have insurance monies reduce its debt by assuming the rights of the mortgagee and initiating a foreclosure action against the mortgagor to recoup amounts paid to the mortgagee. But, where an insurer is liable to a mortgagee, but is not liable to a named insured mortgagor due to the mortgagor's breach of the insurance contract, the mortgagor is not entitled to have the insurance proceeds applied to reduce the mortgage debt.

39 This reasoning leaves no room for the complaint, advanced strenuously by the insurer in this case, that it is suffering financial unfairness because the insured mortgagor has not been making any payments on the mortgage. The insurer cannot show this complaint has any merit without establishing that the insurance policy is void as against the insured. Otherwise, the insurer's payment to the

mortgagee has discharged the principal owing on the mortgage leaving no ongoing payments to be made.

40 The American jurisprudence and commentary reinforces my conclusion that there are two preconditions to the insurer's entitlement to subrogation under the Standard Mortgage Clause. First, the insurer must make payment of the loss award, or part of it, to the mortgagee. Second, the insurer must establish a claim that it has no liability to the mortgagor insured.

41 In this case, the existence of the second precondition is a genuine issue for trial. In its Statement of Claim, Farmers' Mutual pleads that it denied the Pinders' claim "on the basis that their failure to report a material change in risk voided the contract, and alternatively that they had made wilful false statements with respect to their contents claim, issued in their right to recover under the policy." In their statement of defence the Pinders plead that the insurer's right under the Standard Mortgage Clause "is only triggered by Farmers' Mutual not being liable to the Pinders for the fire loss." They also plead that they have not breached the insurance contract, the insurance policy remains in full force and effect, and Farmers' Mutual remains liable to them for payment of the fire loss. The issue raised and joined in the pleadings is a genuine issue for trial. The motion judge erred by granting summary judgment.

Conclusion

42 I would set aside the judgment granted by the motion judge and replace it with an order dismissing Farmers' Mutual's application for summary judgment and granting the Pinders' motion that Farmers' Mutual's action be consolidated or heard together with their action.

43 The appellants' costs of the appeal and their costs of the motion below are fixed, as agreed by counsel, in the amounts of $12,000 and $10,000 inclusive of GST and disbursements respectively.

R.G. JURIANSZ J.A.
D.R. O'CONNOR A.C.J.O.:-- I agree.
R.A. BLAIR J.A.:-- I agree.

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Correction
Released: November 27, 2009

The hearing date has been corrected from September 11, **2008** to September 11, **2009**.

cp/e/qlecl/qljxr/qljyw/qlhcs/qljyw

1 Couch also cites a single authority from the Court of Appeals of Illinois for the proposition that something short of a "legal right" can in appropriate circumstances be sufficient to support a valid claim of nonliability by the mortgagor at p. 224-49 and footnote 12: *Kerber v. Girling*, 254 Ill. App. 1, 1929 WL 3306 (2d Dist. 1929). *Kerber* however cites to the more authoritative Illinois Supreme Court's decision in *Traders' Ins. Co. v. Race,* 142 Ill. 338 (which I also refer to in these reasons) as binding authority while at the same time adopting a less stringent approach. Subsequent Illinois caselaw has rejected the *Kerber* approach in favour of the approach in *Traders' Ins. Co*.: see e.g., *Nagel-Taylor Automotive Supplies, Inc. v. Aetna*

Casualty &Surety Company of Illinois, 103 Ill. App. 3d 100. Further, the facts in *Kerber* are distinguishable from the case at bar - there, while the insurers and the mortgagor were litigating as to whether the policy had been voided by the mortgagor's conduct, in a separate action, the insurance companies were made defendants in foreclosure proceedings initiated by a secured creditor. The *Kerber* decision also relied on the fact that the insurance companies depended on the right of subrogation to properly defend themselves in the foreclosure proceedings.