

Insurance--Rights of Mortgagee Under Mortgagee Clause of Standard New York Fire Insurance Policy (Syracuse Savings Bank v. Yorkshire Insurance Co., 124 N.Y.L.J. 1, col. 1 (N.Y., Aug. 30, 1950))

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immediate care, treatment or observation to ascertain his mental condition, may be removed to the psychopathic division of Bellevue Hospital²⁴ for a period not to exceed sixty days.²⁵

It was held in *Warner v. State*²⁶ that the New York Mental Hygiene Law did not abolish or curtail the common law power of summary arrest and restraint of a mentally ill person when necessary to prevent him from doing some immediate injury to himself or others.

Judge Washington's concurring opinion in the principal case recognizes this co-existing procedure in New York and would apply the common law rule to mitigate the defendant psychiatrist's liability. He argues that the defendant be permitted to submit as grounds for further reduction of damages that he acted in good faith by proving the patient's need for treatment and that the hospitalization was beneficial. He does not believe that Congress intended to penalize physicians "for assuming responsibility and taking the action which membership in their profession and the welfare of the community require."²⁷

It would seem that this view propounds a more sound foundation for deciding cases of this kind as compared to the broad measure of liability imposed by the majority opinion.

It is submitted in cognizance of the increasing mental health problem,²⁸ that existent laws in regard to the procedure of hospitalizing the mentally ill²⁹ could, in many jurisdictions be modified to acknowledge improved medical principles and social concepts.³⁰

INSURANCE — RIGHTS OF MORTGAGEE UNDER MORTGAGEE CLAUSE OF STANDARD NEW YORK FIRE INSURANCE POLICY. — The plaintiff held a mortgage on a building which the owner-mortgagor insured with the defendant company. The policy contained a New

²⁴ N. Y. CITY CHARTER, c. 23, § 583. (The psychopathic ward of the hospital must operate under the New York Code of Criminal Procedure, Section 939.)

²⁵ N. Y. MENT. HYG. LAW § 81.

²⁶ 297 N. Y. 395, 79 N. E. 2d 459 (1948).

²⁷ *Jillson v. Caprio*, 181 F. 2d 523, 525 (D. C. Cir. 1950).

²⁸ Arestad and McGovern, *Hospital Service in the United States*, 143 A. M. A. J., No. 1, p. 25. (In 1949 general patients hospitalized in the United States totaled 1,224,951 and mental patients comprised 675,096 of this total.)

²⁹ FEDERAL SECURITY AGENCY, FSA-A84 (1950). (Eleven states permit temporary admission only after a court order has been obtained. Seven states still have no provision for temporary admission to a state hospital for observation or for emergency commitment without a court order. Eight states still have no provision for voluntary admission to state hospitals. Mentally ill persons may be kept in jail during the commitment process and while awaiting hospital admission in thirty-five states.)

³⁰ See Note, 56 YALE L. J. 1178 (1947) (excellent analysis of this problem).

York standard mortgagee clause. A loss was sustained under the policy. Failing to agree as to the amount of the damage, the owner and the defendant proceeded to an appraisal according to the provisions of the policy. The amount tendered to the plaintiff was refused. The plaintiff stipulated that he had no notice of and did not participate in the appraisal. It was conceded that no fraud or bad faith was present. The Appellate Division reversed the trial court's judgment in favor of the plaintiff. *Held*, reversed for the plaintiff. The language of the mortgagee clause that ". . . the interest of the mortgagee . . . shall not be invalidated by any act or neglect of the mortgagor . . ." can mean but one thing, namely, if any act of the owner operates to the mortgagee's prejudice, it is not binding upon him. Since an appraisal, as conducted in this case, might deprive the mortgagee of his full protection, he is not bound thereby. *Syracuse Savings Bank v. Yorkshire Insurance Co.*, 124 N. Y. L. J. 1, col. 1 (N. Y., Aug. 30, 1950).

The "standard" or "union" mortgagee clause,¹ statutory or otherwise,² is today the accepted method by which a mortgagee's interest is protected under a fire insurance policy. The effect of the clause is with few exceptions³ held to create an independent and separate contract of insurance between the insurer and mortgagee,⁴ securing him from the conditions imposed upon the owner⁵ and making him responsible for his own acts.⁶ The test which the courts apply is whether the mortgagee can qualitatively and quantitatively prove his insurable interest, even though he be not named in the contract of insurance.⁷

Inasmuch as the New York standard fire policy was written to cover all situations, it imposes many obligations relating to matters with which a mortgagee could not comply.⁸ Thus, when the policy is considered in its entirety, with reference to the language of the

¹ N. Y. INS. LAW § 168, subd. 6, provides: "Loss or damage, if any, . . . shall be payable to the mortgagee as interest may appear, and this insurance . . . shall not be invalidated by any act or neglect of the mortgagor. . . ."

² The standard mortgagee clause became effective in New York in 1886, and prescribed by New York Laws 1909, c. 33, § 121.

³ *Erie Brewing Co. v. Ohio Farmers' Ins. Co.*, 81 Ohio St. 1, 89 N. E. 1065 (1909). *But cf.* *Glen Falls Ins. Co. v. Porter*, 44 Fla. 568, 33 So. 473, 479 (1902).

⁴ *Syndicate Ins. Co. v. Bohn*, 65 Fed. 165 (8th Cir. 1894); *Hastings v. Westchester Fire Ins. Co.*, 73 N. Y. 141 (1879); *Overholt v. Reliance Ins. Co. of Philadelphia*, 319 Pa. 340, 179 Atl. 554 (1935).

⁵ *Reeder v. Twin City Fire Ins. Co.*, 5 F. Supp. 805 (S. D. Fla. 1933); *Eddy v. London Assurance Corp.*, 143 N. Y. 311, 38 N. E. 307 (1894).

⁶ *Goldstein v. National Liberty Ins. Co.*, 256 N. Y. 26, 175 N. E. 359 (1931); *Smith v. Union Ins. Co.*, 25 R. I. 260, 55 Atl. 715 (1903).

⁷ *Savarese v. Ohio Farmers' Ins. Co. of Le Roy, Ohio*, 260 N. Y. 45, 182 N. E. 665 (1932) (although the owner repaired premises, mortgagee entitled to the proceeds); *Krause v. Central Ins. Co. of Baltimore*, 40 N. Y. S. 2d 736 (Sup. Ct. 1943).

⁸ *Heilbrunn v. German Alliance Ins. Co.*, 140 App. Div. 557 (1st Dep't 1910), *aff'd*, 202 N. Y. 610, 95 N. E. 823 (1911).

mortgagee clause to the effect that no act or neglect of the insured shall invalidate the mortgagee's insurance, it is readily seen that the general agreement in the body of the policy does not and was not intended to apply to the new interest added by the clause. Otherwise, what meaning could the clause hold? Its language is not ambiguous; its meaning not obscure; it must be permitted to operate.⁹ Logically then, where the two are inconsistent, the special contract relating to the mortgagee's insurance must take precedence.¹⁰ Consequently, even though the appraisal clause¹¹ in the body of the policy does not specifically confer upon the mortgagee the right of participation therein, that provision is not determinative of his rights as it was not intended to bind the mortgagee.¹²

It cannot be questioned that an appraisal conducted by the insured and insurer actually may be of benefit to a mortgagee. But can such an appraisal be deemed to be an "act" or "neglect" contemplated by the mortgagee clause? Obviously, the appraisal itself may not be detrimental, but if conducted without the mortgagee's consent or participation, it would have a prejudicial effect upon his separate interest as a primary party.¹³ And yet, it is this status, as such, which the mortgagee clause seeks to safeguard. It would seem, therefore, that the failure or refusal to acknowledge the mortgagee as a proper party to the proceeding is, of itself, a violation of his rights. In short, who are to be parties to an appraisal proceeding depends upon principles independent of the policy itself,¹⁴ and those principles do not permit the insured to deprive the mortgagee of his right to be a party in the determination of an award to be paid by the insurance company.

The predecessor of the standard mortgagee clause, the "loss payable" or "open" mortgage clause,¹⁵ was the object of much con-

⁹ Reed, *Adm'r v. Firemen's Ins. Co. of Newark*, 81 N. J. L. 523, 80 Atl. 462 (1911); *Eddy v. London Assurance Corp.*, 143 N. Y. 311, 320, 38 N. E. 307, 311 (1894); *Hastings v. Westchester Fire Ins. Co.*, 73 N. Y. 141 (1879); *Beaver Falls Building & Loan Ass'n v. Allemania Fire Ins. Co.*, 305 Pa. 290, 157 Atl. 616 (1931).

¹⁰ *Beaver Falls Building & Loan Ass'n v. Allemania Fire Ins. Co.*, *supra* note 9; *Eddy v. London Assurance Corp.*, *supra* note 9.

¹¹ N. Y. INS. LAW § 168, subd. 6, provides: "In case the insured and this Company shall fail to agree as to the . . . amount of loss, then, . . . each shall select [an] . . . appraiser The appraisers shall first select an . . . umpire An award . . . of any two . . . shall determine the loss"

¹² *Queens Ins. Co. v. Peoples' Union Savings Bank*, 50 F. 2d 63 (3d Cir. 1931); *Phenix Ins. Co. of Brooklyn v. Omaha Loan & Trust Co.*, 41 Neb. 834, 60 N. W. 133 (1894).

¹³ *Lewis v. Guardian Fire & Life Assur. Co.*, 181 N. Y. 392, 74 N. E. 224 (1905) (mortgagee a necessary party); *Steinbach v. Prudential Ins. Co. of America*, 172 N. Y. 471, 65 N. E. 281 (1902) (judgment not binding without beneficiaries' [mortgagees'] presence); see 12 REP. JUDICIAL COUNCIL OF STATE OF N. Y. 176 (1946); N. Y. CIV. PRAC. ACT § 193.

¹⁴ *Jefferis v. London Assurance Corp.*, 16 F. Supp. 590 (Del. 1936).

¹⁵ The usual clause reads: "Loss, if any, under this policy, payable to the mortgagee as his interest may appear."

fusion as concerns assignments¹⁶ and the clause itself. The courts, however, are practically unanimous in holding that, by reason of this clause, the mortgagee becomes a mere appointee to receive the insurance proceeds whose right of recovery may be defeated by the insured prior to the loss.¹⁷ On the other hand, the weight of authority is to the effect that the mortgagee's rights cannot be defeated by an act of the insured subsequent to a loss.¹⁸ Accordingly, the majority of decisions likewise hold that the mortgagee is not bound by an adjustment of loss by the insured and insurer without his knowledge and assent.¹⁹ There is authority to the contrary²⁰ where the policy, in addition, contains provisions authorizing the insured and insurer to conduct an appraisal, ascertain the loss, etc. Out of these judicially scarred remains of the loss payable clause, the standard mortgagee clause was molded to remedy the difficulties heretofore encountered. Since its inception, the courts have persistently maintained that its inclusion safeguards the interests of the mortgagee from impairment by acts of the owner agreeing to an appraisal without his knowledge and consent.²¹

In view of precedents²² and upon principle,²³ the holding

¹⁶ See *Grosvenor v. Atlantic Fire Ins. Co. of Brooklyn*, 17 N. Y. 391, 395 (1858). "There is no just ground for discrimination between this case (loss payable clause) and that of an assignment In either case the insurance is upon the interests of the mortgagor." For a discussion of mortgagee's rights under a policy assigned to him, see Note, 18 L. R. A. 197 (1909).

¹⁷ *Hill v. International Indemnity Co.*, 116 Kan. 109, 225 Pac. 1056 (1924); *Grosvenor v. Atlantic Fire Ins. Co. of Brooklyn*, 17 N. Y. 391 (1858); *Keith v. Royal Ins. Co. of Liverpool*, 117 Wis. 531, 94 N. W. 295 (1903); see Notes, 38 A. L. R. 367 (1925), 18 L. R. A. 199 (1909).

¹⁸ *Georgia Home Ins. Co. v. Stein*, 72 Miss. 943, 18 So. 414 (1895); *Browning v. Home Ins. Co. of Columbus, Ohio*, 71 N. Y. 508 (1877); *Hall v. Fire Association of Philadelphia*, 64 N. H. 405, 13 Atl. 648 (1888); see Notes, 38 A. L. R. 383 (1925), 25 L. R. A. 740 (1910).

¹⁹ *Bergman v. Commercial Union Assur. Corp.*, 92 Ky. 494, 18 S. W. 122 (1896); *Hathaway v. Orient Ins. Co.*, 134 N. Y. 409, 37 N. E. 40 (1892); *Leslie v. Firemen's Ins. Co. of Newark*, 60 Misc. 558, 112 N. Y. Supp. 496 (Sup. Ct. 1908).

²⁰ *Collinsville Savings Soc. v. Boston Ins. Co.*, 77 Conn. 676, 60 Atl. 647 (1905); *Chandos v. American Fire Ins. Co.*, 84 Wis. 184, 54 N. W. 390 (1893).

²¹ *Scottish Union & National Ins. Co. v. Field*, 18 Colo. App. 68, 70 Pac. 149 (1902); *Gordon v. Northwestern National Ins. Co.*, 77 S. W. 2d 512 (Mo. 1934); *Laurenzi v. Atlas Ins. Co.*, 131 Tenn. 644, 176 S. W. 1022 (1915). *Contra*: *Erie Brewing Co. v. Ohio Farmers' Ins. Co.*, 81 Ohio St. 1, 89 N. E. 1065 (1909) (this case relied for authority on *Chandos v. American Fire Ins. Co.*, *supra* note 20, a case decided under a simple loss payable clause); *Dragon v. Automobile Ins. Co.*, 265 Mass. 440, 164 N. E. 383 (1929) (although Massachusetts has recognized the separability of a mortgagee's interest, *Hardy v. Lancashire Ins. Co.*, 166 Mass. 210, 44 N. E. 209 (1896), the *Dragon* case relied on the *Erie Brewing* case, *supra*, which did not afford a mortgagee such recognition. The court also assumed a principal and agent relation between the mortgagee and mortgagor as relates to provisions concerning appraisal, etc. The theory is similar to that developed by some courts under a loss payable clause. See note 20 *supra*.

²² See notes 8, 9 *supra*.

²³ See notes 5, 13 *supra*.

reached in the *Syracuse Savings Bank* case is no more than a logical extension of the protection so consistently afforded mortgagees by the New York courts. The decision is supported by a strong preponderance of authority elsewhere.²⁴

NEGOTIABLE INSTRUMENTS — CONDITIONAL SALE CONTRACT — FINANCE COMPANY NOT A HOLDER IN DUE COURSE.—Defendant, contracting with a seller to purchase a mechanical press, executed both a conditional sale contract and a promissory note upon plaintiff-finance company's blank. The seller assigned the note and contract, which were separated by a perforated line, to the plaintiff. He then failed to deliver the press to the defendant. Plaintiff brought suit on the note upon defendant's refusal to pay. Defendant raised the personal defense of failure of consideration. *Held*, judgment for defendant. When a finance company actively participates in a conditional sale transaction from its inception by counseling and aiding the future vendor-payee, it cannot be regarded as a holder in due course of the note given in the transaction and the defense of failure of consideration may be properly maintained. *Commercial Credit Corporation v. Orange County Machine Works et al.*, 34 Cal. 2d 766, 214 P. 2d 819 (1950).

The position of the assignee-finance company in consumer conditional sales contracts has long been the source of conflicting opinions between both financiers¹ and jurists.² These finance companies, who derive their profit from the discounting of notes, have, in effect, "the actual control and management of the credit and finance of sellers doing a conditional sale business."³ Yet, they attempt to use the shield of a holder in due course⁴ in order to gain the advan-

²⁴ See note 21 *supra*.

¹ Adelson, *The Mechanics of the Instalment Credit Sales*, 2 LAW AND CONTEMP. PROB. 218 (1935).

² WHITNEY, *OUTLINE OF THE LAW OF SALES* § 30 (4th ed. 1947); Schwartz, *Rights of the Holder of a Combined Note and Security Contract*, New York Law Journal, Dec. 28, 1936, p. 2400, cols. 1-3; 53 HARV. L. REV. 1200 (1940).

³ *Buffalo Industrial Bank v. De Marzio*, 162 Misc. 742, 744, 296 N. Y. Supp. 783, 785 (City Ct. 1937), *rev'd on other grounds*, 6 N. Y. S. 2d 568 (Sup. Ct. 1937).

⁴ NEGOTIABLE INSTRUMENTS LAW § 52; N. Y. NEG. INST. LAW § 91: "A holder in due course is a holder who has taken the instrument under the following conditions: (1) that it is complete and regular upon its face; (2) that he became the holder of it before it was overdue, and without notice that it had been previously dishonored, if such was the fact; (3) that he took it in good faith and for value; (4) that at the time it was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it."