

Property Insurance Law

Catherine A. Cooke

Robbins, Salomon & Patt, Ltd., Chicago

Standard Mortgage Clause Preserves Coverage for Mortgagee Notwithstanding Carrier's Denial of Named Insured's Claim

The Illinois Appellate Court First District recently upheld summary judgment in favor of a defendant mortgage loan servicer named as loss payee in an insurance policy, and allowed the defendant to recover despite the fact that the insured owners did not occupy the property which was a condition precedent to coverage. *Stonegate Ins. Co. v. Hongsermeier*, 2017 IL App (1st) 151835, ¶ 1. In doing so, the court found that the insurance policy established a separate contractual relationship between the insurer and loss payee mortgage loan servicer, such that the denial of the insured's claim did not necessarily apply to the mortgagee's interest so long as the mortgagee took steps to secure its claim. *Stonegate Ins. Co.*, 2017 IL App (1st) 151835, ¶ 26. The court concluded that in the absence of an express statement that the policy would be void as to the owners *and* the mortgagee, it was reasonable for the mortgagee to believe that any wrongdoing by the insured owners would not prevent its recovery. *Id.* ¶ 34.

Background Facts and Trial Court Proceedings

In 2009, defendants Mark and Rhonda Hongsermeier (owners) executed a mortgage for property located in Rockford, Illinois. *Id.* ¶ 3. The owners resided at the property from 2004 to November 2010. *Id.* On February 21, 2011, Stonegate Insurance Company (Stonegate) issued a hazard insurance policy to the owners insuring against loss and damage caused to the property by fire, among other perils. *Id.* ¶ 4. In the policy, the insured was defined as the owners and "residents of your household." *Id.* The "insured location" was defined as the "residence premises" which was further defined as "the one family dwelling . . . where you reside." *Id.* The policy also contained a mortgage clause to insure the mortgagee (at the time, GMAC Mortgage, LLC) as the named loss payee. *Id.* The clause read, in relevant part, as follows:

If a mortgagee is named in this policy, any loss payable under Coverage A or B will be paid to the mortgagee and you, as interests appear. * * * If we deny your claim that denial will not apply to a valid claim of the mortgagee, if the mortgagee:

- a. Notifies us of any change in ownership, occupancy or substantial change in risk of which the mortgagee is aware;
- b. Pays any premium due under this policy on demand if you have neglected to pay the premium; and
- c. Submits a signed, sworn statement of loss within 60 days after receiving notice from us of your failure to do so. Policy conditions relating to Appraisal, Suit Against Us and Loss Payment apply to the mortgagee.

Id. The policy also contained a fraud clause which provided:

[T]he entire policy will be void, if whether before or after a loss, an “insured” has:

- a. Intentionally concealed or misrepresented any material fact or circumstance;
- b. Engaged in fraudulent conduct; or
- c. Made false statements; relating to this insurance.

Id.

Stonegate did not inspect the property or speak with the owners before issuing the policy. *Id.* After issuance, Stonegate sent the owners and the mortgagee the policy declaration which indicated it was effective on February 21, 2011, but the mortgagee was not provided with a copy of the policy itself. *Id.*

Prior to and after Stonegate issued the policy, the mortgagee retained CoreLogic Field Services (CoreLogic) to inspect the property. *Id.* ¶ 5. CoreLogic provided five inspection reports to the mortgagee. *Id.* The first four reports described exterior visual inspections occurring in July 2010, September 2010, October 2010, and September 2011. *Id.* Those four reports indicated that the property was occupied but that the inspector had no contact with the occupant. *Id.* The fifth inspection report stated that on November 1, 2011, the inspector communicated with the “tenant” on the property premises. *Id.*

On November 4, 2011, three days after the fifth inspection report, a malfunctioning electrical outlet caused a fire that severely damaged the property. *Id.* ¶ 6. At the time of the fire, the owners had leased the property to tenants who resided in the property. *Id.* GMAC Mortgage, LLC was the servicer of the mortgage loan at the time of the fire. *Id.*

On November 17, 2011, Stonegate filed a declaratory judgment complaint seeking a declaration that it had no duty to pay the owners because they were not occupying the property on the date of the fire. *Id.* ¶ 7. In April 2012, Stonegate filed an amended complaint, joining GMAC Mortgage as a defendant and asserting that it also could not recover under the policy because it knew the owners were not occupying the property before the fire occurred but failed to notify Stonegate as required by the mortgage clause. *Id.* GMAC Mortgage answered the complaint and stated that it had no knowledge that the property was rented at any time prior to the fire. *Id.*

GMAC Mortgage also filed a counterclaim requesting a declaratory judgment that it was insured under the policy and that Stonegate’s denial of the owners’ claim did not affect its claim. *Id.* ¶ 8. In response, Stonegate filed an answer alleging the entire policy was void because the owners concealed or misrepresented that tenants occupied the property and that GMAC Mortgage could not recover because it knew or should have known the property was rented but failed to meet its obligations to notify Stonegate as required in the mortgage clause. *Id.* During the course of the litigation, Ocwen Loan Services, LLC (Ocwen) acquired GMAC Mortgage’s rights in the mortgage loan and was substituted into the case as the defendant and counter-plaintiff. *Id.* ¶ 9.

In March 2014, Ocwen filed a motion for summary judgment alleging that no genuine issues of material fact existed as to whether Ocwen was entitled to recovery under the policy. *Id.* ¶ 10. The circuit court granted Ocwen’s motion for summary judgment, finding that the policy contained a standard mortgage clause that created an independent or separate insurance contract between the parties, and therefore the owners’ alleged failure to notify Stonegate of an occupancy change was not, by itself, a defense to Ocwen’s claim. *Id.* The trial court also noted that because the owners did not reside at the property when the policy was issued, there was no change in ownership, occupancy, or a substantial change in risk for Ocwen to report to Stonegate. *Id.* Stonegate appealed.

Appellate Court Ruling

On appeal, Stonegate argued that the trial court erred in granting summary judgment and allowing Ocwen to recover under the policy because the owners' occupancy of the property was a condition precedent to coverage. *Id.* ¶ 12. Stonegate further argued that questions of fact existed as to whether the mortgage clause provided Ocwen with coverage, as its predecessor knew or should have known the property was rented but failed to notify Stonegate as required. *Id.* Lastly, it contended that the fraud clause precluded coverage for the owners and Ocwen because the owners purposely concealed the leasing of the property. *Id.*

Ocwen argued that the trial court correctly held that the owners' leasing of the property did not allow Stonegate to deny coverage to the mortgagee because the policy contained a "standard mortgage clause" that protected it from the owners' acts or omissions; there was no change of occupancy or substantial change of risk during the policy period; and the fraud clause did not exclude coverage for Ocwen because the loss did not result from its breach of the policy. *Id.* ¶ 13.

After reciting the familiar rules regarding interpretation of insurance policies, the appellate court began by noting that there are two well-recognized types of mortgage clauses in property insurance policies that protect mortgagees against losses or damages to a mortgaged property: the simple mortgage clause and the standard mortgage clause. *Id.* ¶ 17; *Old Second Nat'l Bank v. Indiana Ins. Co.*, 2015 IL App (1st) 140265, ¶ 20. In a simple mortgage clause, "a mortgagee is merely an appointee who receives insurance proceeds subject to its interest in the policy and to the extent of the insured's right of recovery." *Stonegate Ins. Co.*, 2017 IL App (1st) 151835, ¶ 17 (citing *Posner v. Firemen's Ins. Co.*, 49 Ill. App. 2d 209, 216 (1st Dist. 1964)). A mortgagee's rights under a simple mortgage clause are wholly dependent on the insured's rights and are subject to all of the same defenses to coverage as the insured. *Stonegate Ins. Co.*, 2017 IL App (1st) 151835, ¶ 17.

On the other hand, a standard mortgage clause creates a separate and independent contract between the insurer and mortgagee. *Old Second*, 2015 IL App (1st) 140265, ¶ 20. Under a standard mortgage clause, the mortgagee is only liable for its own breaches and is protected from being denied coverage due to the acts or omissions of the named insured or the insured's noncompliance with the policy's terms. *Id.* (citing *West Bend Mut. Ins. Co. v. Salemi*, 158 Ill. App. 3d 241, 246-47 (2d Dist. 1987) and *City of Chicago v. Maynur*, 28 Ill. App. 3d 751, 753-54 (1st Dist. 1975)).

Ocwen relied on *Old Second* to argue that the policy contained a standard mortgage clause that protected GMAC Mortgage from the owners' act or omissions. *Stonegate Ins. Co.*, 2017 IL App (1st) 151835, ¶ 18. Stonegate did not dispute that the policy contained a standard mortgage clause, but instead argued that *Old Second* was a case of first impression and that Ocwen's argument was based almost exclusively on out-of-state authorities. *Id.* The appellate court pointed out that while the trial court granted summary judgment before the *Old Second* decision was issued, Stonegate's notice of appeal was filed after the decision was issued. *Id.* ¶ 19.

It is well-established that Illinois courts retroactively and prospectively apply decisions to cases that are pending at the time they are issued. *Id.* While a court may decline to provide a decision retroactive effect where it expressly states that the decision will be applied only prospectively or the decision establishes a new principle of law, the *Old Second* court did neither. *Id.* ¶¶ 19-20. Though the *Old Second* court did decide an issue of first impression as to the interplay between a standard mortgage clause and a vacancy provision, the decision was not the first to recognize that a standard mortgage clause protects the mortgagee from being denied coverage based on the insured's acts or omissions. *Id.* ¶ 20.

The appellate court then engaged in a review of *Posner v. Firemen's Ins. Co.*, 49 Ill. App. 2d 209 (1st Dist. 1964) and *West Bend Mutual Insurance Co. v. Salemi*, 158 Ill. App. 3d 241 (2d Dist. 1987), both of which were decided and in effect prior to *Stonegate*. In *Posner*, the court found that the insurance policy did not contain a standard mortgage clause, while still recognizing that a standard mortgage clause specifically protects the mortgagee from acts or omissions of the named insured. *Posner*, 49 Ill. App. 2d at 214-15. Thereafter, the *Salemi* court followed *Posner* in recognizing that a standard mortgage clause specifically protects a mortgagee from acts or omissions of the named insured and supports recovery directly by a mortgagee. *Salemi*, 158 Ill. App. 3d at 246-47.

The appellate court noted that the mortgage clause at issue in *Stonegate* used language similar to the loss payable clause in *Old Second*, and concluded that the mortgage provision constituted a standard mortgage clause and accordingly the denial of the owners' claim did not necessarily apply to Ocwen's interest. *Stonegate Ins. Co.*, 2017 IL App (1st) 151835, ¶ 24. The court also found that even if the mortgage clause did not amount to a standard mortgage clause, the policy still established a separate contractual relationship between Stonegate and GMAC Mortgage. *Id.* ¶ 24. The language in the policy provided that denial of the insured's claim did not necessarily apply to the mortgagee's interest if the mortgagee took the required steps to secure its claim. *Id.* ¶ 26. That language evidenced a recognition by Stonegate that GMAC Mortgage had an interest in the policy separate and distinct from the owners' interest. *Id.*

After concluding that the denial of the owners' claim for policy benefits did not necessarily affect Ocwen's claim, the appellate court considered the argument that GMAC Mortgage was obligated to notify Stonegate of a change in occupancy or substantial change of risk under the mortgage clause. *Id.* ¶ 27. Based on the appellate court's review of the record, it found that there was no evidence presented to establish that GMAC Mortgage was aware that the owners were not occupying the property prior to the fire. *Id.* ¶ 28.

The first four inspection reports did not indicate who was occupying the property and while the fifth report referred to a "tenant," Stonegate failed to present evidence that notice to CoreLogic constituted notice to GMAC Mortgage. *Id.* Even if GMAC Mortgage had notice due to the fifth inspection report, the mortgage clause was silent as to when notice to Stonegate was required. *Id.* Seeing as the fire occurred just three days after CoreLogic's fifth inspection report and the language of the mortgage clause which only provided that GMAC Mortgage was to "notify [Stonegate] of any change in occupancy of which it 'is aware,'" there was no way to determine whether GMAC Mortgage failed to comply with the notice requirement. The appellate court rejected the remainder of Stonegate's factual arguments as to why GMAC Mortgage should have known that the owners were not occupying the property. *Id.* ¶ 29.

The court also pointed out that the language of the mortgage clause required GMAC Mortgage to notify Stonegate of any change in ownership, occupancy or substantial change in risk, and a review of the record revealed that the owners had already leased the property to tenants before Stonegate issued the policy. *Id.* ¶ 30. Therefore, the court found that even if there was a question as to when GMAC Mortgage first learned the owners were not occupying the property, it was irrelevant in determining whether GMAC Mortgage complied with the mortgage clause conditions. *Id.*

Finally, the appellate court rejected Stonegate's arguments that the fraud clause barred Ocwen's claim. *Id.* ¶ 32. The fraud clause provided that the entire policy would be void if, before or after a loss, "an insured" intentionally concealed or misrepresented any material fact or circumstance or made false statements. *Id.* Stonegate argued that this provision applied to all insureds, including Ocwen. The court looked to *Salemi* for guidance, concluding that in the absence of an express statement that the policy would be void as to both the owners and the mortgagee, it was reasonable for the mortgagee to believe that its interest was separately covered by the policy and that the insured's wrongdoing would not prevent its recovery. *Id.* ¶¶ 33-34.



Practical Takeaways

The *Stonegate* ruling provides a thorough discussion of the differences between a standard and simple mortgage clause and whether the policy language employed will protect a mortgagee from wrongdoing by the insured which may invalidate the insured's claim. Insurers and their counsel should carefully inspect mortgage clauses to ensure that mortgagee claims will stand even when an insured's acts, omissions, or fraudulent misrepresentations ultimately bar coverage for the insured's claims. Mortgagees are also reminded to take all necessary steps to provide requisite notice to the insurer of any changes in risk if the policy so provides.

About the Author

Catherine A. Cooke is a shareholder at *Robbins, Salomon & Patt, Ltd.* and concentrates her practice in the area of commercial litigation and creditors' rights. She earned her undergraduate degree from Indiana University–Bloomington in 2003, and law degree from The John Marshall Law School in 2006, where she served as Administrative Editor of *The John Marshall Law Review*. She is licensed to practice law in both Illinois and Indiana.

About the IDC

The Illinois Association Defense Trial Counsel (IDC) is the premier association of attorneys in Illinois who devote a substantial portion their practice to the representation of business, corporate, insurance, professional and other individual defendants in civil litigation. For more information on the IDC, visit us on the web at www.iadtc.org or contact us at PO Box 588, Rochester, IL 62563-0588, 217-498-2649, 800-232-0169, idc@iadtc.org.