SUPREME COURT OF CANADA

CITATION: Royal Bank of Canada *v.* State Farm Fire and Casualty Co., [2005] 1 S.C.R. 779, 2005 SCC 34

DATE: 20050609
DOCKET: 30275, 30231

BETWEEN:

Royal Bank of Canada
Appellant
v.
State Farm Fire and Casualty Company
Respondent

AND BETWEEN:

Michael Ian Beardall Alexander
Appellant
v.
State Farm Fire and Casualty Company
Respondent

CORAM: McLachlin C.J. and Major, Bastarache, Binnie, LeBel, Abella and Charron JJ.

REASONS FOR JUDGMENT: (paras. 1 to 31)

Major J. (McLachlin C.J. and Bastarache, Binnie, LeBel, Abella and Charron JJ. concurring)

Royal Bank of Canada *v*. State Farm Fire and Casualty Co., [2005] 1 S.C.R. 779, 2005 SCC 34

Royal Bank of Canada *Appellant*

v.

State Farm Fire and Casualty Company *Respondent*

and between

Michael Ian Beardall Alexander *Appellant*

v.

State Farm Fire and Casualty Company *Respondent*

Indexed as: Royal Bank of Canada *v*. State Farm Fire and Casualty Co.

Neutral citation: 2005 SCC 34.

File Nos.: 30275, 30231.

2005: April 13; 2005: June 9.

Present: McLachlin C.J. and Major, Bastarache, Binnie, LeBel, Abella and Charron JJ.

on appeal from the court of appeal for ontario

Insurance — Fire Insurance — Statutory conditions — Material change to risk — Vacancy — Mortgage clause — Insured house vacated by owners at time of fire — Insurer not notified of vacancy — Mortgagees making claim under insurance policy pursuant to standard mortgage clause — Statutory condition permitting avoidance of insurance contract if insurer not promptly notified of any change material to risk within control and knowledge of insured — Insurer denying claim, asserting vacancy was "change material to the risk" — Whether insurer may void coverage on basis mortgagees failed to notify it that house had been vacated.

A fire destroyed a house. By the time of the fire, the insured house had been vacated by the owners and was controlled by the mortgagees. The mortgagees made an insurance claim pursuant to the standard mortgage clause in the policy. The insurer denied the claim because it had not been informed of the vacancy of the house. It asserted that the vacancy was a "change material to the risk and within the control and knowledge" of the mortgagees and that, under Statutory Condition 4, it was entitled to void coverage. The mortgagees sued the insurer, alleging breach of the policy. The Ontario Superior Court of Justice found that although Statutory Condition 4 did not conflict with the mortgage clause it was not applicable in the circumstances of this case. The Court of Appeal set aside the decision and granted judgment in favour of the insurer.

Held: The appeal should be allowed.

Statutory Condition 4 cannot be relied on by the insurer to void coverage. In light of the wording of the mortgage clause, terms of the policy that conflict with that clause, including exceptions to the mortgagor's coverage, do not affect the mortgagees' coverage. Here, Statutory Condition 4 conflicts with the mortgage clause. The conflict arises because Statutory Condition 4 would permit the insurer to void coverage on the basis of a "change material to the risk and within the control and knowledge of the Insured" of which it was not notified. On the assumption that "Insured" means the mortgagor, this right cannot be reconciled with the mortgage clause, which provides that the mortgagees' coverage shall remain in force despite any act of the mortgagor — including an act causing a "change material to the risk". The conflict remains if one assumes that the reference to "Insured" captures mortgagees as well as the mortgagor. While the conflict is avoided if "Insured" is read to mean only a mortgagee, such a reading is untenable. [22-26]

Moreover, on the facts of this case, even if there were no conflict and the insurer could make out a "change material to the risk" within the control and knowledge of the mortgagees, it could not rely on that change to void the coverage insofar as the change related to vacancy or non-occupancy of the insured house. The mortgage clause clearly states that the mortgagees' coverage shall remain in force "notwithstanding . . . any vacancy or non-occupancy" attributable to the mortgagor. [29]

Cases Cited

Referred to: *National Bank of Greece (Canada) v. Katsikonouris*, [1990] 2 S.C.R. 1029.

Statutes and Regulations Cited

Insurance Act, R.S.O. 1990, c. I.8, Part IV.

APPEAL from a judgment of the Ontario Court of Appeal (McMurtry C.J.O. and Doherty and Blair JJ.A.) (2004), 69 O.R. (3d) 591, 6 C.C.L.I. (4th) 20, 181 O.A.C. 134, [2004] I.L.R. ¶ I-4263, [2004] O.J. No. 91 (QL), reversing a decision of Wilton-Siegel J. (2002), 43 C.C.L.I. (3d) 274, [2003] I.L.R. ¶ I-4154, [2002] O.J. No. 4209 (QL). Appeal allowed.

Richard Horodyski and *Amanda Jackson*, for the appellant Royal Bank of Canada.

Michael Ian Beardall Alexander, on his own behalf.

David Zarek, for the respondent.

The judgment of the Court was delivered by

1 MAJOR J. — A fire destroyed a house insured by the respondent, State Farm Fire and Casualty Company (the "Insurer"). By the time of the fire, the house had

been vacated by its owners and controlled successively by the appellants, Royal Bank of Canada and Michael Alexander, who held respectively first and second mortgages over the property on which the house was located. The appellants claimed under the insurance policy issued by the Insurer pursuant to the standard mortgage clause contained in it.

2 This appeal asks whether the Insurer can avoid the policy, and thereby deny the appellants' claims, on the basis that the appellants failed to notify it that the house had been vacated. For the reasons that follow, it cannot. The appeal is allowed.

I. Facts

3 After purchasing a house near London, Ontario, in 1997, Julaine and Todd Deeks insured it against fire through a homeowner's insurance policy with the Insurer.

4 On April 16, 2000, the Deeks' house was destroyed by a fire of unknown cause. The Deeks were unharmed, having several months earlier defaulted on their mortgages with the appellants and vacated their house after the commencement of power of sale proceedings.

5 Between the time the Deeks vacated the house and the time of the fire, the house remained unoccupied at all times. However, the appellants, in succession, secured and maintained it.

6 While the appellants may have exercised some control over the Deeks' property in taking sensible steps to maintain its value, neither ever became its owner.

While both appellants, at various times, could have sought an order for foreclosure, which would have transferred ownership of the property, neither opted for this remedy. Each chose to proceed by power of sale. At the time of the fire, the appellant Alexander had only commenced an action for payment under the mortgage and for possession of the property.

7 Neither the Deeks nor the appellants notified the Insurer that the house was vacant.

8 The Deeks' insurance policy with the Insurer included, in standard form, the following clause for the benefit of mortgagees such as the appellants (the "Mortgage Clause"):

> (Approved by the I.B.C.): 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.
>
> . . .
>
> In the absence of the Insured, or the inability, refusal or neglect of the Insured to give notice of loss or deliver the required Proof of Loss under the Policy, then the Mortgagee may give the notice upon becoming aware of the loss and deliver as soon as practicable the Proof of Loss.
>
> The term of this mortgage clause coincides with the term of the Policy; PROVIDED ALWAYS that the Insurer reserves the right to cancel the Policy as provided by Statutory provision but agrees that the Insurer will

> neither terminate nor alter the Policy to the prejudice of the Mortgagee without the notice stipulated in such Statutory provision.
>
> Should title or ownership to said property become vested in the Mortgagee and/or assigns as owner or purchaser under foreclosure or otherwise, this insurance shall continue until expiry or cancellation for the benefit of the said Mortgagee and/or assigns.
>
> SUBJECT TO THE TERMS OF THIS MORTGAGE CLAUSE (and these shall supersede any policy provisions in conflict therewith BUT ONLY TO THE INTEREST OF THE MORTGAGEE), loss under this Policy is made payable to the Mortgagee. [Emphasis added.]

9 The policy also included this provision ("Statutory Condition Number 4"):

> Any change material to the risk and within the control and knowledge of the Insured voids the contract as to the part affected thereby, unless the change is promptly notified in writing to the Insurer or its local agent, and the Insurer when so notified may return the unearned portion, if any, of the premium paid and cancel the contract, or may notify the Insured in writing that, if he desires the contract to continue in force, he must, within fifteen days of the receipt of the notice, pay to the Insurer an additional premium and in default of such payment the contract is no longer in force . . . . [Emphasis added.]

Statutory Condition Number 4 appears in every contract made in Ontario providing "insurance against loss of or damage to property arising from the peril of fire" by virtue of Part IV of the *Insurance Act*, R.S.O. 1990, c. I.8.

10 Pursuant to the Mortgage Clause, the appellants filed claims with the Insurer respecting the loss caused by the fire. The Insurer denied those claims. It asserted that the vacancy of the Deeks' house was a "change material to the risk" within the control and knowledge of the appellants of which it had not been notified, and that it was thus entitled to avoid payment under the policy pursuant to Statutory Condition Number 4.

11 The appellants sued the Insurer, alleging breach of the policy. All parties moved for summary judgment upon a determination by the court as to whether the Insurer could void the appellants' coverage.

II. Judicial History

A. *Ontario Superior Court of Justice* (2002), 43 C.C.L.I. (3d) 274

12 Wilton-Siegel J. stated that Statutory Condition Number 4 did not conflict with the Mortgage Clause. The Mortgage Clause dealt with changes in risk brought about by the mortgagor and within a mortgagee's knowledge, whereas Statutory Condition Number 4 spoke to changes in risk within a mortgagee's knowledge and control. In his view, Statutory Condition Number 4 would allow the Insurer to void the coverage of a mortgagee who failed to notify the Insurer of a "change material to the risk" within its control and knowledge.

13 Wilton-Siegel J. determined that Statutory Condition Number 4 was not applicable in the circumstances. The only "change material to the risk" occurred when the Deeks vacated their house. Neither of the appellants was in a position to reverse that change as neither had title. Accordingly, neither could be said to have had control over the change.

14 On that basis, Wilton-Siegel J. granted judgment in favour of the appellants.

B. *Court of Appeal for Ontario* (2004), 69 O.R. (3d) 591

15 Doherty J.A., speaking for the unanimous court, agreed with Wilton-Siegel J. that Statutory Condition Number 4 did not conflict with the Mortgage Clause. However, unlike Wilton-Siegel J., he considered that Statutory Condition Number 4 had been triggered by the appellants and that the Insurer could thus void the policy. In his view, the continued vacancy of the Deeks' house after the appellants gained control of it was a "change material to the risk" existing at the inception of the policy within the appellants' control and knowledge.

16 In the result, the court allowed the appeal, and granted judgment in favour of the Insurer.

III. Issues

17 The appeal raises two issues:

1. Does Statutory Condition Number 4 permit the Insurer to void the coverage granted to a mortgagee by the Standard Mortgage Clause in the event of a "change material to the risk" within the control and knowledge of that mortgagee of which the Insurer is not notified?

2. If so, was there a "change material to the risk" within the control and knowledge of either of the appellant mortgagees of which the Insurer was not notified?

18 In light of my conclusion respecting the first issue, I do not address the second.

IV. Analysis

19 Terms such as the Mortgage Clause are "the standard vehicle by which mortgagees insure their interest in encumbered property": *National Bank of Greece (Canada) v. Katsikonouris*, [1990] 2 S.C.R. 1029, at p. 1047. They allow mortgagees to "piggyback" on the insurance purchased by mortgagors, and represent "the most economical, rational, and fair procedure for effecting insurance on the interest of mortgagees": *Katsikonouris*, at p. 1053.

20 The wording of the relevant mortgage clause determines the scope of coverage granted to a mortgagee. In *Katsikonouris*, La Forest J. held that the mortgage clause at issue protected the coverage of the mortgagee from any misrepresentation by the mortgagor, including one made before the issuance of the policy. Though La Forest J. discussed the existence of an independent contract between the insurer and the mortgagee created by the mortgage clause, it is clear that the mortgagee's protection from misrepresentations contained in that contract was founded on the "simple and untechnical language" of the clause (p. 1038).

21 In this case, the Mortgage Clause provides that "loss under this Policy is made payable to the Mortgagee". Taken on its own, that statement suggests that mortgagees obtain, by way of the Mortgage Clause, coverage that is subject to all of the terms of the policy.

22 However, the Mortgage Clause also provides that its terms "shall supersede any policy provisions in conflict therewith BUT ONLY TO THE INTEREST OF THE

MORTGAGEE". This means that terms of the policy that conflict with the Mortgage Clause, including exceptions to the mortgagor's coverage, do not affect the mortgagees' coverage.

23 Statutory Condition Number 4 conflicts with the Mortgage Clause. It therefore cannot be relied on by the Insurer to void the coverage granted to the appellants by the Mortgage Clause.

24 The conflict arises because Statutory Condition Number 4 would permit the Insurer to void coverage on the basis of a "change material to the risk and within the control and knowledge of the Insured" of which it was not notified. On the assumption that "Insured" means the mortgagor, this right cannot be reconciled with the first paragraph of the Mortgage Clause, which provides that the mortgagees' coverage shall remain in force despite any act of the mortgagor — including, necessarily, an act causing a "change material to the risk" — and that the mortgagee shall pay for any resulting "increase of hazard . . . during the continuance" of coverage.

25 The situation does not change if one assumes that the reference to "Insured" in Statutory Condition Number 4 captures mortgagees as well as the mortgagor. The aforementioned conflict remains.

26 The only way the conflict between Statutory Condition Number 4 and the Mortgage Clause is avoided is if the word "Insured" in Statutory Condition Number 4 is read to mean only a mortgagee, and not the mortgagor. Such a reading is untenable, for two reasons.

27 First, the Mortgage Clause expressly distinguishes a mortgagee from the "Insured". It states:

> In the absence of the Insured, or the inability, refusal or neglect of the Insured to give notice of loss or deliver the required Proof of Loss under the Policy, then the Mortgagee may give the notice upon becoming aware of the loss and deliver as soon as practicable the Proof of Loss.

Such language accords with the policy's declarations page, which refers to the Deeks as "NAMED INSURED", and to the appellants as mortgagees.

28 Second, reading the word "Insured" to mean only a mortgagee where it appears in other parts of the policy leads to absurd results. For instance, the policy provides that it "may be terminated . . . by the Insured at any time on request". If, in relation to that term, "Insured" were read to mean a mortgagee and not the mortgagor, a mortgagee could unilaterally terminate the policy taken out by the mortgagor, while the mortgagor itself could not.

29 There is a further conflict between Statutory Condition Number 4 and the Mortgage Clause raised by the facts of this case. The "change material to the risk" within the control and knowledge of the appellants alleged by the Insurer stems from the Deeks' vacating the insured house. Yet the Mortgage Clause says the appellants' coverage shall remain in force "notwithstanding . . . any vacancy or non-occupancy" attributable to the mortgagor (i.e., the Deeks). Even if Statutory Condition Number 4 did not more generally conflict with the Mortgage Clause, and the Insurer could make out a "change material to the risk" within the control and knowledge of the appellants, it could not rely on that change to void the appellants' coverage insofar as the change related to vacancy or non-occupancy of the insured house. To allow it to

do so would defeat the Insurer's promise contained in the Mortgage Clause of continued coverage in the event of a vacancy.

30 If the Insurer wished to be able to void a mortgagee's coverage in the event of a "change material to the risk" within that mortgagee's control and knowledge of which it was not notified, it should have used clear language to that effect. It cannot expect this Court to contort the Mortgage Clause and Statutory Condition Number 4 in order to fulfill its unreflected, but professedly true, intention.

V. Conclusion

31 Statutory Condition Number 4 conflicts with the Mortgage Clause and is thus superseded in accordance with the latter's final paragraph. The Insurer cannot rely on it to void the appellants' coverage and deny their claims. The appeal is allowed with costs to the appellants throughout, on a party-and-party basis.

Appeal allowed with costs.

Solicitors for the appellant Royal Bank of Canada: Gowling Lafleur Henderson, Hamilton.

Solicitors for the respondent: Zarek Taylor Grossman Hanrahan, Toronto.