COURT FILE NO.: 01-3805
DATE: 20021101

ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:	
Royal Bank of Canada	*Richard Horodyski*, for the Plaintiff
Plaintiff	
- and -	
State Farm Fire and Casualty Company	*David Zarek*, for the Defendant
Defendant	
AND BETWEEN:	**COURT FILE NO.: 36671**
Michael Ian Beardall Alexander	*Troy H. Lehman*, for the Plaintiff
Plaintiff	
- and -	
State Farm Fire and Casualty Company	*David Zarek*, for the Defendant
Defendant	
	HEARD: August 26 & 29, 2002

H. WILTON-SIEGEL J.:

[1] These motions, which are being heard together, relate to actions which are occasioned as a result of a fire which took place on April 16, 2000 at a home which was the subject of power of sale proceedings instituted by the first and second mortgagees on the property. Each of the plaintiffs has, in effect, brought a motion for:

1. a determination of the following question of law which will dispose of all or part of the relevant action and entitle the relevant plaintiff to judgment:

   is State Farm Fire and Casualty Company ("State Farm") entitled to avoid its policy of insurance with the relevant plaintiff?

   and

2. on the basis of that determination, which they assume to be favourable to the plaintiffs, or otherwise a motion for summary judgment.

[2] For its part, State Farm, the defendant in each action, has moved for summary judgment. While the motion materials do not expressly so indicate, counsel for the defendant confirmed upon the hearing of the motions that the defendant was also seeking a determination of the question of law set out above in connection with its motions for summary judgment. In his Statement of Claim, the plaintiff Michael Alexander ("Alexander") also claimed punitive damages for breach of the duty of good faith and fair dealing. At the hearing of these motions, counsel for Mr. Alexander advised that this claim was being withdrawn and that, accordingly, this motion for summary judgment and the cross-motion of State Farm would not extend to the claim for punitive damages.

[3] The parties have agreed to the following facts:

The Claim

1. Both of these actions are occasioned as a result of a fire which took place on April 16, 2000 at approximately 4 a.m. The said fire took place at the home owned by Julaine Deeks. The home was located at Lot 30, Concession 1, Biddulph Township near London, Ontario (hereinafter referred to as the “Property”). This was a 2 story detached home with attached double garage. It had a full basement.

2. As owners and occupiers of the Property, Todd Deeks and Julaine Deeks applied for a fire insurance policy on their home (hereinafter referred to as the “Policy”) with the defendant State Farm. As set out in the application for insurance, this was their principal residence.

3. At the time of this fire, the Plaintiffs, Alexander and the Royal Bank of Canada (the "Royal Bank") were mortgagees under the Policy. Alexander and the Royal Bank claim for payment under the Policy with State Farm.

The Parties

4. Alexander is an individual who has made investments in mortgages. He was called to the Bar as a lawyer in Ontario in 1990 and initially worked in the wills & trust area of the profession from 1990 to 1993. After 1993 he maintained non-practising status with the Law Society of Upper Canada. Since 1993 he has been self-employed as a professional speaker, writer and consultant and he has a book called, "How to Inherit Money". Alexander has held mortgages on other properties.

5. The Royal Bank is a financial institution incorporated pursuant to federal laws and carries on business as a bank with significant experience in financial transactions including mortgage transactions.

6. State Farm is an insurance company licensed to issue insurance policies pursuant to the *Insurance Act*, R.S.O. 1990, c. I.8 and has significant experience in issuing insurance policies.

The Insured Property

7. On March 3, 1997, Julaine Deeks became the registered owner of the Property. Thereafter, Juliane Deeks commenced residing at the Property with her husband, Todd Deeks (collectively, the "Deeks").

The Royal Bank Mortgage

8. On December 15, 1997, a Charge/Mortgage of Land was registered upon the Property with the Royal Bank as mortgagee and Julaine Deeks as mortgagor (the "Royal Bank Mortgage"). The Royal

Bank Mortgage was guaranteed by Todd Deeks.

9. The terms of the Royal Bank Mortgage included the following:

   (a) Principal amount of $187,000.00;

   (b) Interest at a rate of 5.95% per annum;

   (c) Monthly payments of principal and interest in the amount of $1,190.89; and

   (d) Term of five years, ending on December 15, 2002.

The Alexander Mortgage

10. On March 18, 1998, a Charge/Mortgage of Land was registered upon the Property with Alexander as mortgagee and Julaine Deeks as mortgagor. This mortgage was guaranteed by Todd Deeks. The terms of the Charge/Mortgage registered on March 18, 1998 were as follows:

   (a) Principal amount of $38,000.00;

   (b) Interest at a rate of 15% per annum;

   (c) Monthly interest payments of $475.00; and

   (d) Term of one year, ending on March 19, 1999.

11. On May 19, 1999, Alexander loaned a further $5,000 to Julaine Deeks. A further Charge/Mortgage was registered on the Property with Alexander as mortgagee, Juliane Deeks as mortgagor and Todd Deeks as guarantor.

12. The terms of the Charge/Mortgage registered on May 19, 1999 were as follows:

   (a) Principal amount of $43,000.00;

   (b) Monthly interest payments of $537.50; and

   (c) Term of one year, ending on May 19, 2000.

The Insurance Policy

13. The Property was insured against loss caused by fire under the Policy.

14. The Policy was subject to a limit of liability of $154,050 for damage to the dwelling on the Property (the "Dwelling").

15. The Royal Bank was named as first mortgagee on the Policy and Alexander was named as second mortgagee on the Policy. Each is an Insured under the Policy.

16. The Policy included a Mortgage Clause set out herein:

> 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.
> ….
> 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.

The Policy included the following exclusion:

> **We** do not insure:
>
> 1. loss or damage occurring after **your dwelling** has been vacant for more than 30 consecutive days. A **dwelling** being

constructed is not considered vacant.

The Policy also included Statutory Condition Number 4, which provided as follows:

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.

17. When the first mortgage of March 18, 1998 was taken out, Alexander's solicitors requested a copy of the Policy. In response to this, State Farm sent a copy of the declarations page which is its standard practice. No further request was made for a copy of the policy booklet at that time or when the second mortgage dated May 19, 1999 was taken out. Alexander has issued mortgages on a number of houses and he says that it would be unusual for him to receive a copy of a policy booklet from any insurer. Alexander says that he relies upon the declarations page from the insurer to indicate the amount of coverage, the basic kind of coverage and whether the insurance is in good standing. He says that he does not rely upon the declarations page in any other manner.

Power of Sale Proceedings

18. On June 16, 1999, the Deeks defaulted on the Royal Bank Mortgage.

19. Around that same time, the Deeks defaulted under the terms of the Alexander Mortgage by failing to make the required monthly payments because they were in financial difficulty.

20. On or about August 17, 1999, Alexander served a Notice of Sale under the Alexander Mortgage with a redemption date of October 4, 1999. The Notice of Sale indicated that the amount due on the Alexander Mortgage for principal money, interest and costs was $46,075.00 as of July 19, 1999. The 45-day redemption period passed and the Alexander mortgage was not brought back into

good standing.

21. Julaine Deeks moved out of the Dwelling on or about September 16, 1999. Juliane Deeks removed her personal items from the Dwelling and did not return to live in the Dwelling at any time after September 1999. She did return two to three times over the next one and one-half months to make sure all of her personal items were removed. She never went into the house thereafter.

22. On October 12, 1999, Alexander's solicitors wrote the Deeks as follows:

> We have instituted power of sale and the time period for redemption has expired. We understand that Juliane Deeks is no longer on the premises but that Todd Deeks is still there. Please advise forthwith upon receipt of this letter as to whether or not you will voluntarily lease [*sic*] the premises or if legal action will have to be taken by way of a Writ of Possession which will only add to the mortgage debt. Please advise.

The Deeks did not respond to this letter. The Plaintiff Michael Alexander commenced Power of Sale proceeding on or after August 17, 1999.

23. On October 14, 1999, the Royal Bank served a Notice of Sale under the Royal Bank Mortgage with a redemption date of November 24, 1999. The Notice of Sale indicated that the amount due on the Royal Bank Mortgage for principal money, interest and costs was $187,948.02 as of October 14, 1999. The Royal Bank Notice of Sale was served upon Alexander and received by Alexander on or about October 20, 1999.

24. On November 1, 1999, Alexander's solicitors wrote again to the Deeks asking whether the Deeks would consent to a judgement on the covenant under the mortgage and for a writ of possession. In exchange for the consent judgment, Alexander was prepared to hold the judgment in abeyance until January 1, 2000 to allow the Deeks time to sell the property. The Deeks did not respond to this letter.

Remco

25. After commencing power of sale proceedings in October 1999,

Royal Bank retained Remco Financial Services ("Remco") to perform weekly property inspections. The Property was inspected by Remco on October 14, 22, 29 and November 5 and 12, 1999. On each of these occasions Remco noted that the Property was occupied.

26. The property was inspected by Remco on November 19, 1999. At that point, Remco noted that a realtor confirmed the property to be vacant. Therefore, Todd Deeks vacated the Property at some time between November 12, 1999 and November 19, 1999. After he left the Property some time between November 12 and November 19, 1999, Todd Deeks did not return. When he left the property some time between November 12 and November 19, 1999, Todd Deeks removed his personal belongings from the house. From this point until the time of the fire, the Property was vacant. From this point until the time of the fire, neither Mr. Deeks nor Mrs. Deeks had any dealings with either the Royal Bank or Alexander aside from receiving a Statement of Claim from Alexander. The Deeks did not ask for and were not provided with a key to the dwelling. At no time prior to the fire did the Deeks, the Royal Bank or Alexander advise State Farm of any of the above.

27. On November 20, 1999, Remco completed the following tasks:

    (a) Changing the locks and securing the windows;

    (b) Gathering and removing flyers, leftover perishable foods, flammables and hazardous waste;

    (c) Checking electrical heating and plumbing systems;

    (d) Re-routing utilities;

    (e) Draining plumbing and applying glycol to plumbing and traps; and

    (f) Draining and turning off the hot water tank.

28. After November 20, 1999, Remco did not attend at the Property. On November 20, 1999 Royal Bank took control of the Property by changing the locks and maintaining the only set of keys to the Property.

Alexander Brings Royal Bank Mortgage Into Good Standing

29. On November 26, 1999, Alexander's solicitors wrote to Royal Bank's solicitors attaching certified cheques totalling $9,155.34. This brought the Royal Bank Mortgage into good standing, thereby allowing Alexander to control the power of sale proceedings. Remco then provided Alexander's solicitors with the keys to the Dwelling. At that point, Remco's services were terminated by the Royal Bank. After this, the Royal Bank had no further dealings with the Property aside from the fact that it continued to be paid by Alexander. Alexander took control of the Property by maintaining the only set of keys to the Property.

30. Alexander made four payments of $1,190.89 to keep the Royal Bank mortgage in good standing from December 1999 to March 2000.

31. After assuming control of the Power of Sale proceedings, Alexander retained the services of two real estate agents to list and sell the Property through the Multiple Listing Service (more particularly described below).

32. Between February 17, 2000 and April 10, 2000, the Property was visited by real estate agents with prospective purchasers on at least 13 occasions. The property was last visited by a real estate agent and a prospective purchaser on April 10, 2000, six days before the fire.

33. In addition to the above visits by real estate agents and prospective purchasers, the Property was visited by Bob Hardy, an individual retained by the listing real estate agent to plow snow. Mr. Hardy visited the Property on 11 occasions in January and February 2000.

34. Alexander personally inspected the property once in December 1999, and once in January 2000. One of the purposes of these inspections was to ensure that the Property was secure. His inspection of the Property indicated that it was safe and he inspected the doors and windows. Aside from the above, he did not take any further steps to secure the Property or to make sure that the Property was safe because he concluded that there was nothing else he could do in that regard.

Alexander Action against the Deeks

35. By Statement of Claim dated February 2, 2000, Alexander commenced an action against the Deeks for payment under the mortgage and for possession of the Property. The amount claimed was $61,080.06 plus interest since the date of filing. This action was defended by Statement of Defence dated March 1, 2000. This action has not proceeded to judgment.

The Fire and Claims against State Farm

36. On April 16, 2000, the Dwelling was destroyed by fire.

37. The office of the Fire Marshal conducted an investigation into the cause of the fire. The fire burned the home to the ground and no part of it was left standing. The fire was called in at 4:33 a.m. When the fire fighters arrived, they discovered the house fully involved with fire. The roof was already gone and only some of the wood frame of the house was still visible through the flames. Due to the totality of destruction, the Fire Marshal could not determine the cause of the fire.

38. At no time either before or after November 20, 1999 until the April 16, 2000 fire did Royal Bank or Alexander or anyone on their behalf advise State Farm that the Deeks had moved out of the Dwelling and had not returned, that the Property was unoccupied, that the mortgagees had taken control of the Property by maintaining the only set of keys to the Property[1], that power of sale proceedings had been commenced or that Alexander had commenced an action against the Deeks for payment under the Alexander Mortgage. State Farm only became aware of these facts after the fire of April 16, 2000.

39. Alexander's solicitors advised State Farm of the fire by letter dated April 18, 2000.

40. Under cover of letters dated June 20, 2000, State Farm provided Royal Bank and Alexander with an estimate of the damages to the Property totalling $177,847.92.

41. On July 13, 2000, Alexander provided State Farm with a Sworn

[1] Royal Bank between November 20, 1999 and November 26, 1999 and Mr. Alexander thereafter.

Statement in Proof of Loss in the amount of $180,000.

42. On July 20, 2000, Royal Bank provided State Farm with a Sworn Statement in Proof of Loss, claiming its mortgage debt of $183,012.87 as at July 13, 2000.

43. By letter dated March 5, 2001, State Farm advised Royal Bank and Alexander that the Policy was being voided effective January 7, 2000. By letter dated March 6, 2001, Royal Bank and Alexander were advised by State Farm that their claims were not payable because, in State Farm's view, the Policy had been voided and was not in force as of the date of the fire. It is State Farm's position that the Policy was voided because had it known of the circumstances set out above, the company would have cancelled the Policy before the end of the term of the Policy (which had been April 30, 2000) and would have given the Royal Bank and Alexander the required Statutory Notice of 15 days as required under Statutory Condition number 5.

> 5. a. This contract may be terminated:
>
> (1) by the Insurer giving to the Insured fifteen days' notice of termination by registered mail or five days' written notice of termination personally delivered;

44. In State Farm's view, the Policy was voided because the circumstances set out above constituted a material change of risk being insured. Given the facts set out above, especially the facts that the Property was vacant or that the mortgagees had taken control of the premises by maintaining the only set of keys to the Property[2], it is State Farm's position that there was an increased risk of damage to the premises. As such, it is State Farm's position that it would not have continued to insure this risk. This factual situation would have caused any other similar insurer to either cancel its policy or to increase the premium charged. This would be standard industry practice.

45. In State Farm's view, the Policy coverage would have ceased on January 7, 2000. Therefore, State Farm says that their Policy would not have been in force at the time of this fire.

[2] Royal Bank between November 20, 1999 and November 26, 1999 and Mr. Alexander thereafter.

46. Neither Julaine Deeks nor Todd Deeks have commenced any action against State Farm and the limitation period for doing so has long since expired.

The Sale of the Property

47. Julaine Deeks listed the Property for sale on June 26, 1999.

48. The Property was ultimately sold by Alexander under power of sale by Agreement of Purchase and Sale dated June 11, 2001. The sale price was $130,000. After the payment of real estate brokerage fees, outstanding taxes and penalties and legal fees, $103,019.83 was paid to Royal Bank on or about July 12, 2001.

[4] The agreed facts do not include a statement that the vacancy of the Property which occurred on the departure of Todd Deeks constituted a "change material to the risk" for the purposes of the Statutory Condition. However, upon the hearing of the motion, counsel for each of the parties confirmed that this was their understanding. Counsel also confirmed that the parties agree that the quantum at issue in the aggregate in both matters is $154,050, being the policy limit.

[5] The central issue in this matter is the proper interpretation of each of the exclusion for vacancy of the dwelling (referred to as the "Vacancy Exclusion") and the statutory condition number 4 (referred to as the "Statutory Condition") in light of the mortgage clause (referred to as the "Mortgage Clause), all as set out in paragraph 16 of the Agreed Statement of Facts in the particular circumstances of this matter.

[6] It is settled law that the effect of the Mortgage Clause establishes a contractual relationship between the insurer and the mortgagee. The legal effect was set out in *London L. & S. Co. of Canada* v. *Union Ins. Co. of Canton Ltd.*, [1925] 4 D.L.R. 676 at 679 (H.C.); affd. [1925] 4 D.L.R. 680 (C.A.) as follows:

> The effect of such a mortgage clause is to bring the insurer and the mortgagee into privity, to convert the mortgagee into a party to the contract of insurance, to give to the mortgagee separate and distinct protection as to his interest, to create in him an interest in the policy distinct from that of the property-owner, and in fact to make him an insured…

[7] In my opinion this principle is best expressed by stating that the Mortgage Clause establishes a separate, independent contract of insurance between the mortgagee and insurer which incorporates the other terms of the underlying insurance policy to the extent they are

applicable. In order to answer the question of law on which the parties seek a determination it is therefore necessary to establish the terms of this separate, independent contract, or more particularly, the extent to which the Vacancy Exclusion and the Statutory Condition are terms of this contract.

[8] The plaintiffs' position is that neither the Vacancy Exclusion nor the Statutory Condition should operate in these circumstances. I believe their position is summarized as follows:

1. the Mortgage Clause overrides both the Vacancy Exclusion and the Statutory Condition; or

2. to the extent it does not, neither the Vacancy Exclusion nor the Statutory Condition obligates a mortgagee exercising power of sale proceedings to give notice to the insurer of any vacancy arising on the departure of the mortgagor from the insured premises.

[9] I will deal with each of these arguments in turn. Before so proceeding it should also be mentioned that the Royal Bank also asserted certain additional defences specific to itself based on the nature and extent of its involvement with the property. In view of the decision reached in this matter, I will address its specific defences only briefly at the end of these reasons.

[10] The plaintiffs' first position is that the Mortgage Clause overrides the other two provisions and represents the totality of the contract between the parties with respect to the vacancy of the Property. The only penalty specifically set out in the Mortgage Clause for failure to notify the defendant of a vacancy or non-occupancy is the requirement to pay an increased premium on demand. It is, therefore, the plaintiffs' contention that failure to notify the insurer of the vacancy of the property for more than thirty days did not void the policy but sounded only in damages. In support of this position they rely on the *London L. & S. Co.* case referred to above as well as *Royal Insurance Co. of Canada* v. *Gordon* (1981), 125 D.L.R. (3d) 372 (N.S. CA.), *Citicorp Realty Ltd.* v. *Zurich Insurance Co.* (1983), 1 C.C.L.I., 222 and *Montreal Trust Co.* v. *Dominion of Canada General Insurance Co. et al* (1987), 46 R.P.R. 102 (H.C.J.). In particular they rely on the *Royal Insurance* case as authority for the proposition that the principle operates even where the mortgagee has knowledge of the vacancy and has taken control of the premises and boarded it up. As a subsidiary argument they assert that to void an insurance policy as against a mortgagee based on failure to report an act or omission of the mortgagor, including vacating the premises, would require clear and unambiguous terms. They cite the *London L. & S. Co.* and *Citicorp Realty* cases in support of this position. Other than with respect to the Statutory Condition, which they acknowledge is a statutory provision incorporated into the insurance policy and is therefore to be interpreted otherwise, the plaintiffs urge that any ambiguities in the contract be resolved in favour of the plaintiffs on the basis of the *contra proferentum* rule.

[11] The defendant takes the position that the Mortgage Clause does not set out the entire contract between the insurer and the mortgagee. Rather than superseding the entire insurance

contract, the Mortgage Clause has the effect of making the mortgagee an insured under the policy on a basis which incorporates all of the terms and conditions of the underlying insurance contract. On this approach the defendant asserts that if the mortgagee wishes to assert its rights it must do so subject to all of the terms and conditions of the contract of insurance. In particular the defendant takes the position that all of the exclusions in the underlying insurance contract will remain as between the insurer and the mortgagee unless specifically dealt with by the mortgage clause. In taking this position the defendants rely on several more recent cases than those relied upon by the plaintiffs: *Royal Bank of Canada* v. *Red River Valley Mutual Insurance Co.* (1986), 41 R.P.R. 295 (Man. C.A.), *Economical Mutual Insurance Co.* v. *State Farm Insurance Co.*, [1999] O.J. No. 3885 (S.C.J.) and *Royal Bank of Canada v. Safeco Insurance Co. of America*, [1988] A.J. No. 214 (Q.B.).

[12] The defendant takes the position that there is no inconsistency between the Mortgage Clause and the Statutory Condition which requires the insured to notify the insurer of any change material to the risk within the control and knowledge of the insured. In its view the Mortgage Clause does not limit the defendant's remedy to an increased premium upon failure by the mortgagee. It merely states that the mortgagee shall pay the increased premium on demand, assuming notice has been given, while the Statutory Condition gives the insurer the option upon receipt of notice to terminate the policy or demand the increased premium. This view was expressed by the Alberta Court of Queen's Bench in *Royal Bank v. Safeco* which appears to have regarded the approach adopted in the *Red River Valley Mutual* case as supportive of its view. While neither the defendants nor the Alberta Court of Appeal expressly state the limit of this principle, I understand it to apply only to notices of events which materially change the risk and are within the *control* and knowledge of the insured. In other words the insurer is not entitled to terminate the policy under the Statutory Condition if the mortgagee fails to give notice of an event which constitutes a change material to the risk of which it has knowledge if the event was not also within the control of the mortgagee. In such event the only remedy of the insured lies in damages under the provisions of the Mortgage Clause unless another exclusion beyond the Statutory Condition is available to it.

[13] The defendant distinguishes the four cases relied upon by the plaintiff on two grounds. The defendants point out correctly that in each of these cases the court was only asked to address the operation of the Mortgage Clause and that the interaction between the Statutory Condition and the Mortgage Clause apparently was not put to the court for its consideration**.**

[14] I agree with the submissions of defendant's counsel that the principle articulated in the *London L. & S. Co., Citicorp Realty, Montreal Trust Co.* and *Gordon* cases is not applicable to the extent that the issue of the interaction of the Mortgage Clause and the Statutory Condition is before the Court. More generally I agree with the comments of Brennan J. in the *Economical Mutual Insurance* case that, while the Mortgage Clause is to be treated as a contract between the insurer and the mortgagee, the Mortgage Clause does not supersede the entire insuring contract. In particular, as a matter of construction of the contract between the parties, the exclusions remain unless they are specifically dealt with by the Mortgage Clause or are excluded by ordinary principles applicable to the interpretation of contracts.

[15] It is therefore necessary to consider the operation of each of the Statutory Condition and the Vacancy Condition.

[16] With regard to the operation of the Statutory Condition, the policy is voidable by the insurer if the insurer is not notified of "any change material to the risk and within the control and knowledge of the Insured". The issue in this case is whether the vacancy of the Property, which it is agreed was a change material to the risk which came to the knowledge of the plaintiffs, was within their control.

[17] Defendants' counsel argued that the test of control for these purposes is satisfied if the mortgagees had either physical control of the risk or the power to take possession of the property and remove the occupants. He referred to the case of *Watkins v. Portage La Prairie Mutual Insurance Co.*, [1986] B.C.J. No. 598 (C.A.) at paragraph 22 as authority for the proposition that, for the purposes of the Statutory Condition, control means "physical control" of the risk. In support of the alternative, he relied on *Mueller v. Wawanesa Insuranc*e Co., [1995] O.J. No. 3807 (Gen. Div.) which appears to have decided that the test of control of the risk was satisfied in respect of rental premises if the landlord had the legal basis for terminating a tenancy. Applying these tests to this action, the defendant's counsel argued that the test was satisfied on the basis of each test. In his view the mortgagees had taken physical possession of the property in a manner which satisfied the test. In addition he argued that the right of the mortgagees to seek foreclosure or a right of possession was the substantive equivalent of the right of the landlord in *Mueller* to terminate the tenancy in that case.

[18] The plaintiffs argued that control was restricted to physical control. In their view the fact that a party has the power to take legal proceedings to effect a change does not mean that the party has control over the change. The plaintiffs relied on the apparent determination in the *Watkins* case that the right to apply to court for an order of termination of a lease or an order of possession did not amount to control in circumstances where the court doubted, as a practical matter, whether the landlord would be able to obtain physical possession even with such an order.

[19] Applying this test to this case, the plaintiffs argued that neither a mortgagee instituting power of sale proceedings nor a mortgagor unilaterally leaving the mortgaged premises constitutes a change material to the risk within the control of the mortgagee for the purposes of the Statutory Condition. The plaintiffs relied on the statements of O'Brien J. in *Dexfield Investments Inc*. v. *Co-operators Co.*, [1992] O.J. No. 1614 (Gen. Div.) at page 8, which, although they may be obiter in that case, express this principle:

> Counsel for the defendant in this case argued that the actions of the plaintiff herein in commencing the Power of Sale proceedings and in issuing and serving the writ of possession resulted in a change of circumstances "within control" of the plaintiff.

> I do not accept that argument. I do not agree those acts were acts of control by a mortgagee which brought about a change in the risk.

[20] I believe the correct principle is that stated in the *Dexfield* case which, although ultimately decided on the basis that the plaintiff did not have knowledge of the vacancy for more than thirty days, is very instructive for the present matter. The issue is to some extent miscast when framed in terms of the presence or absence of a requirement for physical control. In my view, the test is whether the mortgagee is in a position to reverse the change in the risk which occurred on the vacancy of the Property. This is the test articulated, correctly in my view, in the *Wawanesa* case in paragraph 12:

> In considering the issue of control, the plaintiff and Furmston indicated they had difficulties in terminating the tenancy as the tenants remained current within 60 days. However, I am satisfied that the plaintiff would have had little difficulty in terminating the lease as it had expired in accordance with the terms of the offer to lease. Further, the use of the premises had changed from being that of a residence to an operating towing and storage business adjoining a fortified gutted building. The landlords would have had little difficulty in terminating this tenancy had they wished to do so, thus the change was within their control.

It is not the right to terminate the lease but the power of the landlord to restore the property to its original use which is the litmus test in these circumstances. Whether or not that power can be demonstrated to exist in any particular circumstance will depend, among other things, upon the nature of the risk which must be restored and the power and rights of other parties interested in the relevant property.

[21] In the case of a mortgagee, while the institution of notice of sale proceedings may have been a factor, even an important factor, in the decision of Todd Deeks to vacate the Property, it was not the sole cause. It cannot be said that the mortgagees caused the vacancy, much less could restore the Property to the original level of risk, as only occupation by a mortgagor having an interest in the Property would satisfy this test and the default of the mortgagors under the mortgage made this unattainable. On this view, it is only after completion of foreclosure proceedings, when title is acquired by the mortgagee, that notice must be given to avoid the risk of avoidance of the policy. In this case, the correct interpretation of the insurance contract between the insurer and the mortgagees is, in my opinion, that while the Mortgage Clause did not override the Statutory Condition, the policy could not be voided by the insurer as the change in the risk was not within the control of the mortgagees.

[22] This view is supported in my opinion by the decisions in all of the cases presented in argument on this motion. In each of the *London L. & S. Co.*, *Citicorp Realty*, *Gordon* and *Montreal Trust Co.* cases, as counsel for the defendant pointed out, the issue of control by the mortgagee was absent with the result that the Mortgage Clause governed. At the other end of the spectrum, in each of the *Red River Valley Mutual* and *Safeco* cases the mortgagees actually acquired title and by taking that action had necessarily and unilaterally changed the risk

associated with the relevant property. Only two cases directly address the facts presented in this case. The *Economical Mutual* case, however, does not address the issue of the operation of the Statutory Condition but is restricted to a consideration of a particular exclusion. On the other hand, while ultimately deciding the case on a different basis, the Court expressly stated in *Dexfield* that it did not agree that commencement of power of sale proceedings and issuing and serving a writ of possession were acts of control of a mortgagee which brought about a change of risk. The effect of these cases, in my opinion, is to provide that the Mortgage Clause and the Statutory Condition co-exist, with the Mortgage Clause setting out the general remedy available to the insurer in the event the mortgagee receives knowledge of, and fails to give notice of, any of the enumerated changes to the risk and the Statutory Condition providing an additional remedy of a right to void the Policy where the particular change to the risk was within the control as well as the knowledge of the mortgagee.

[23] Although this point was not argued by counsel before me, I believe there is also indirect support for this interpretation in the Mortgage Clause itself. The penultimate paragraph of the Mortgage Clause reads as follows:

> 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.

As indicated above, the parties agree that vacancy of the property is regarded in the insurance industry as a material change in risk. Given that vacancy of the property typically occurs at some stage of foreclosure proceedings, I believe the fact that the Mortgage Clause assumes continuation of the policy through the completion of foreclosure proceedings is significant. If it were intended that vacancy would give rise to a right to terminate, the Mortgage Clause would be expected to deal more explicitly with the right and obligations of the parties upon such occurrence in the course of foreclosure proceedings.

[24] Counsel for the defendant also proposed an approach to the co-existence of the Mortgage Clause and the Statutory Condition based on the circumstances by which the mortgagee received knowledge of the event constituting the material change in risk. In his view, the Mortgage Clause should operate only with respect to such information to the extent it is passively received. If, however, it is "actively" acquired, that is acquired by virtue of the mortgagee's control of the insured property, the mortgagee's obligations should be subject to compliance with the Statutory Condition. I do not believe this distinction is supported by the language of the Policy. In fact I think this argument merely begs the question of what constitutes control for the purposes of applying this distinction in practice. I do not believe this approach is supported by the cases unless it is simply another way of articulating the test set out in paragraph 20 above.

[25] The Vacancy Condition constitutes an exclusion under the Policy "for loss or damage occurring after your dwelling has been vacant for more than 30 consecutive days". The exclusion operates irrespective of the knowledge or control of the mortgagee. As such it clearly

conflicts with the Mortgage Condition which requires notice of any vacancy extending beyond thirty days which comes to the knowledge of the mortgagee. It also conflicts with the Statutory Condition which operates to void a contract only as to changes in risk within the control and knowledge of the mortgagee.

[26] In my opinion, the proper interpretation of these provisions in the contract requires that the Mortgage Clause be given full effect. On this basis it follows that the Vacancy Exclusion cannot be treated as incorporated into the contract between the mortgagees and the insured. To do so would override entirely the provisions of the Mortgage Clause as to the knowledge limitation. In addition, because the effect of the Vacancy Exclusion is to exclude liability altogether, it renders unnecessary the provisions in the Mortgage Clause which create a right in favour of the insurer to avoid the policy. For these reasons I am of the opinion that the insurer is not entitled to rely upon the Vacancy Exclusion to deny liability under the Policy in respect of the mortgagees.

[27] Counsel for the plaintiffs also argued that the use of the phrase "your dwelling" in the Vacancy Exclusion in the underlying policy should be interpreted as indicating an intention that the Vacancy Exclusion shall not operate in respect of mortgagees. The defendant's counsel pointed out the definitions of "you" and "your" in the Policy do not support this interpretation. These definitions, however, in turn refer "to the person named as Insured on the Declarations". In view of the conclusions reached above with respect to the inability of the defendant to rely upon the Vacancy Exclusion, it is unnecessary to reach a conclusion on this issue and, as I have not had the benefit of a full argument on the issue, I decline to do so.

[28] In its argument, the plaintiff Royal Bank also argued that its knowledge of the vacancy of the Property was limited to knowledge of six days of vacancy, being the period between November 20 and November 26, 1999. The parties agree that vacancy occurred sometime between November 12 and November 19, 1999, and that the Royal Bank took control of the Property on November 20, 1999, by changing the locks and maintaining the only set of keys to the Property which Alexander's solicitors received from the agent of the Royal Bank. After this date the Royal Bank had no further dealings with the Property apart from being paid by Alexander on its mortgage and the services of its property agent were terminated.

[29] The consequence of this limited involvement may well be that the insurer is unable to rely upon either the Mortgage Clause or the Statutory Condition in respect of the Royal Bank. However, in view of the conclusions I have reached with respect to the operation of these provisions in this matter, it is unnecessary to reach an opinion on this issue and I have not done so.

[30] Accordingly, the questions of law with respect to the entitlement of State Farm to avoid its policies of insurance with Alexander and Royal Bank are each answered in the negative. As the parties have agreed that there are no other issues for trial in each of these actions, judgment will be entered:

1. in favour of Alexander in action #36671; and

2. in favour of Royal Bank in action #01-3805.

H. Wilton-Siegel J.

Released: November 1, 2002

COURT FILE NO.: 01-3805
DATE: 20021101

ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:

Royal Bank of Canada

Plaintiff

- and –

State Farm Fire and Casualty Company

Defendant

A N D B E T W E E N:
COURT FILE NO.: 36671

Michael Ian Beardall Alexander

Plaintiff

- and -

State Farm Fire and Casualty Company

Defendant

REASONS FOR JUDGMENT

H. Wilton-Siegel J.

Released: November 1, 2002