Thirdly, if a MIG policy is for the joint benefit of the borrower what would be the position if, when a borrower was in arrears, the insurer elected to operate the "buy-out" clause prior to the property being re-possessed and sold? Would the lender be obliged to apply the proceeds from the MIG policy to the credit of the borrower's account, thereby clearing any arrears and putting the account into credit?

6. Conclusion

6.1 The main reason why insurers had their fingers burnt in the mortgage indemnity insurance market was the combination of the boom in lending of the 1980s and of lenders (and insurers) failing to underwrite these risks adequately. Each was relying on the other. However, as we said at the beginning, the problems have, touch wood, largely been remedied.

SUBROGATION UNDER MORTGAGE INDEMNITY GUARANTEES AN ALTERNATIVE VIEW

by Giles Morgan - Head of Legal Services Alliance & Leicester

I had the privilege of reading, albeit with increasing alarm, a copy of Professor Adams' article on this subject prior to its publication in the issue dated . I am most grateful to Professor Adams for the opportunity to do so.

My alarm stems from the fact that if the arguments put forward by Professor Adams are correct, it is a recipe for the unscrupulous to avoid their proper obligations on the one hand, and for further substantial increases in premiums damaging the chances of a sustained recovery in the housing market, on the other. I hope that the comments set out below will show why a Court can, and should, be very reticent in following the decision in *Mark Rowlands Limited v Berni Inns Limited (1986) 1Q.B211, (1985) 3 All E.R.473* ("the Mark Rowlands case") in relation to mortgage indemnity insurance ("MIG").

It is undeniable that the scenario outlined by Professor Adams is typical of the majority of residential loans made by lending institutions, particularly building societies. However, it is important, in my view, to put the reference to "...insistence

by the lender on the issue of a mortgage indemnity guarantee..." into perspective. The only reason for this requirement is that the borrower has insufficient funds of his or her own and wants a loan larger than the lender feels that it would be prudent to advance, having regard to the value of the property and the borrower's financial resources. Time was when borrowers were required to have a savings record with the building society before they could borrow - not so in the age of consumerism!

The lender requires some additional security for that "excess" advance. This, in my view, is quite proper having regard to the lender's duty to its shareholders or members. This additional security does not have to be MIG. It could be other property or shares or any other form of suitable security. Regrettably, building societies are constrained, at the moment, as to the type of security which they can take and which counts as being of a "prescribed description" within the Building Societies Act 1986 (section 11(4)), and they have problems of classification where other land is concerned (sections 11 and 12 of the 1986 Act). Accordingly, MIG is popular because it is easily available through the mechanism of a block policy, and relatively cheap being a single premium covering a 25, or sometimes longer, term of years. The repayments are infinitesimal when spread over that period (even if interest is added).

Professor Adams finds a parallel between the circumstances surrounding loss caused by negligence in a landlord and tenant relationship, as in the Mark Rowlands case, and loss resulting from a breach by a borrower under the terms of a mortgage, in the case of MIG. I suggest, however, that there are important distinctions. In the Mark Rowlands case Kerr L.J. laid emphasis upon the terms of the lease and to a lesser extent on the insurance policy (see paragraph e at page 476 of the All England Law Report and the exhaustive analysis which then followed). The lease, in the Mark Rowlands case, contained the following provisions, none of which are prevalent in MIG, namely:-

(i) a covenant by the landlord to insure;

(ii) a provision that the tenant was to be relieved from its repairing obligations in the event of damage by an insured risk (in this case fire); and

(iii) a covenant by the landlord to lay out the insurance monies to rebuild the premises.

Indeed, there was a right for the tenant in the Mark Rowlands case to have its interest noted on the insurance policy, although this was not done. These are explicit obligations undertaken by two parties to preserve, for their future mutual benefit, an asset (in this case a building) in which they both have an interest in its continued existence. Professor Adams refers to the speech by Glidewell L.J. in which the latter said (pg.486 para 6) "...Thus in this case the risk which led to payment of the insurance moneys was one of the risks envisaged in the agreement between the parties that the plaintiffs should take out insurance...". Earlier in his short speech, Glidewell L.J. had referred to ".... a contractual obligation to the defendants...". The emphasis is all on specific obligations leading to the conclusion that the landlord and the tenant intended the parties to mutually benefit from the insurance. This is different from the situation in relation to MIG. There is no covenant nor, in my view, any agreement, implicit or otherwise, by the lender to insure, let alone to relieve the borrower from liability under the mortgage deed, nor to oblige the lender to look to the insurance monies to pay the debt first. I do not accept, as Professor Adams states, that there is an implied bargain that the lender will look to the MIG security. Nor do I find any mutual interest between the borrower and the lender as there is between the landlord and tenant. The lender wants repayment of its capital and interest over the term since that is how it makes its profit. The borrower on the other hand, really wants to be able to pay the debt off as soon as possible in order that he or she can own the property. The lender has no interest in ownership of the property.

In support of the implicit agreement between lender and borrower, Professor Adams refers to the obligation on building societies to give a Notice to their borrowers that the MIG policy is being taken as additional security. The purpose of that requirement is that, without it, the borrower "...may be trapped into taking on commitments larger than they would in the absence of the financial support of the third party - the extent of whose participation may be unknown to the borrower". (see Wurtzburg & Mills Building Society Law paragraph 5.22). In other words the lender is saying, by service of the Notice, "Be sure that you can afford the whole amount of this loan (for which you are primarily responsible)", and not "Don't worry if you cannot pay part of this loan, we've got insurance for us and you".

In my view, therefore, the only similarity between the circumstances surrounding the landlord and tenant relationship outlined in the Mark Rowlands case and that between the borrower and lender in relation to MIG is that the borrower pays the premium (as did the tenant in the Mark Rowlands case). As I read the judgement of

Kerr L J that was one, but not the only, factor which lead the Court of Appeal to conclude that the tenant did have a limited interest in the policy.

I also feel that it is also instructive to read the judgements in three of the cases decided by the Supreme Court of Canada *(Agnew-Surpass Shoe Stores Ltd v Cummers-Yonge Investments Ltd (1975 55 DLR (3d) 676; T Eaton Co Ltd v Smith (1977) 92DLR (3d) 425 and Greenwood Shopping Plaza Ltd v Neil J Buchannan Ltd (1979) 99DLR (3d)289)* which were relied upon in the Mark Rowlands case. These cases, which were also concerned with a landlord and tenant relationship, also exhaustively examined the wording of the documentation and surrounding correspondence to determine whether the tenants were exonerated from liability in negligence. On balance, in those cases the tenant was taken to have the benefit of the policy since, in the words of Laskin C J C in the Agnew-Surpass case:

> "When all the foregoing provisions of the lease are read together, they force the conclusion that the lessee is to have the benefit of fire insurance to be effected by the lessor in respect of loss or damage arising from the lessees negligence..." But, as it was stated by the same judge in the T Eaton Co case (which was also referred to by Kerr L J at para 1 on p.483 in the Mark Rowlands case) "...Had the landlord insured without giving a covenant to that effect in the lease, the tenants risk of liability for fire resulting from negligence would be unquestionable; and if the landlord collected from his insurer, the latter would have an especially unquestionable right of leasing from the tenant in a subrogated action..".

In my View, that is precisely what happens in MIG. The borrower covenants to repay the debt, the borrower defaulting, a loss arises, the sale proceeds fail to recover the debt., the lender recovers from the insurer under the M.I.G. Policy, and the insurer stands in the same position as the lender, ie to sue on the personal covenant. There is no discharge of the debt. So, the insurer's right of subrogation is unassailable. There is support for this proposition from some decisions of the U.S. Courts. For example, it has been held that a policy may validly provide that an insurer shall be subrogated to the mortgagees rights, upon payment of a loss to the latter *(Hill v Massachusetts Fire & Marine Ins. Co- 1938, 113 S.W.2d 104).* Indeed, this result has been held to apply even where the premiums had been paid by the borrower *(Washington Fire Ins. B. v Gibb Tea. Gr. App- 1914. 163 SW 608).* If, as Professor Adams suggests, the lender must "on any default look to your double security, first the property and secondly, the M.I.G.", the logical conclusion is that

the lender must always enforce its security. What about the lender's rights to sue on the personal covenant to pay the mortgage debt, or to appoint a receiver? Are these to be ignored at the insistence of the borrower?

I find no express or implied obligation on a lender in relation to MIG to insure, and in the absence of that agreement there is, in my view, no exemption for the borrower from his or her agreement to service the debt. Even if I am wrong and there are, in some circumstances an "...implicit bargain..", I would argue that this is insufficient to exempt a borrower from liability, particularly if the borrower has been negligent. There is a general presumption of contractual construction which holds that it is exceedingly unlikely that one party to a contract intended to relieve the other of negligent liability unless the clearest possible terms are used *(Gillespie Bros. v Roy Bowles Transport (1973) Q)B)400; Smith v South Wales Switchgear Ltd (1978) 1 WLR 165; Comyn Ching & Co (London) Ltd v Oriental Tube Co Ltd (1981) Com LR67).* This view is further supported by the judgement of the New Zealand Court of Appeal in *Marlborough Properties Ltd v Marlborough Firbreglass Ltd (1981) lN2LR 464,* the facts of which are similar to the Mark Rowlands case - although, interestingly, it does not appear to have been cited to the Court of Appeal in the latter case. In the New Zealand case the lease placed the cost of insurance on the tenant. The issue was, therefore, whether, as a matter of necessary implication from the lease, the parties had agreed that the tenants, having paid the insurance premiums, would not be liable in damages to the landlords if the premises were damaged by fire as a result of the negligence of the tenants. The Court of Appeal held after consultation of the Canadian cases referred to above that there was no such implied agreement. Cooke J. observed (468)

> "There is nothing positive in the lease to indicate that the parties intended to negative the lessee's liability for negligence ... Nor can I see that an implication to that effect is necessary to give the lease business efficiency. On the contrary, if the lessee remained liable for negligence it had an added inducement to be more careful in carrying on its business..."

Can the same not also be said of M.I.G.? The fact that the borrower remains liable under a subrogated claim is an added inducement to the borrower to be more careful in taking out credit.

This brings me to the comment about the contractual basis raised by Professor Adams. In my view, it is not whether there is a contract between the lender and the

borrower (in my view there is, but subject to the right of the lender to instant and peremptory withdrawal before completion) but whether there is a contractual relationship between the borrower and insurer. It is undoubted law that "a person not a party to a contract can neither sue to enforce it nor rely upon it to protect himself from liability, except in cases of agency or trust which must be supported by persuasive evidence". *(Greenwood Shopping Plaza Limited v Beattie and Other 111D.L.R.(3d) 257* citing with approval *Scruttons Ltd- v Midland Silicons Ltd. (1962) AC446).* In the Greenwood case the landlord, whilst precluded from asserting a claim for loss by fire against the lessee, was not precluded from suing the lessee's individual employees whose negligence had caused loss. In MIG where is the relationship between the insurer and the borrower? The lender negotiates a block policy and the premium is calculated by reference, amongst other things, to the volume of business that it is anticipated will be written, the claims experience of the individual lender, its procedures in assessing mortgage security and its procedures for recovery. These are nothing to do with individual borrowers. Lenders are entitled to, and do, come to negotiations for settlement of claims with their insurers without any reference to the borrower. The borrower is, effectively, a third party whose default causes the insurer to pay. Surely the insurer then has a right against the third party? I draw further support for this conclusion from the 3judgement of the *House of Lords in Hobbes v Marlow (11) 78 AC 16* which decided that the insurers payment does not extinguish the insured's right of action against a third party.

The third aspect of Professor Adams' article refers to insurable interests. I accept that both the borrower and the lender have an insurable interest, but I am not convinced that they have the same one. It is, I think, instructive to complete the definition of *Laurence J. in Lucena v Crawford (1806) 2 Bos. & P.N.R. 269* at 302, namely. And whom it importeth, that its condition as to safety or other quality should continue .... To be interested in the preservation of a thing, is to be so circumstanced with respect to it as to have benefit from its existence, prejudice from its destruction .... The borrower is interested in preserving the mortgaged property, whilst the lender is interested in preserving the mortgage debt and the security. These are not the same thing.

In conclusion, I would like to refer to two passages quoted by Kerr and Glidewell LJJ- in the Mark Rowlands case. Both passages arise from the speech by Lord Reid in *Parry v Cleaver (1969) l All E R 555.* The first is "Surely the distinction between receipts which must be brought into account and those which must not must depend

not on their source but on their intrinsic nature". The essential nature of MIG is that it is to provide the lender with extra security so that it will advance the borrower more money than the lender would normally do without that policy. It is not a policy to absolve the borrower from the covenants to pay the mortgage debt.

The second passage refers to considerations of justice, reasonableness and public policy ...... (page 484, para. j). The legacy of negative equity and sales of repossessed properties for less than the accrued debt is a recent phenomenon regrettable though it is. But it should not cloud the issues. Is it just reasonable, or in accordance with public policy that the "not that I can't pay, old boy, just that I won't pay" brigade should be allowed to renege on their proper and freely entered into obligations? I hope that this "alternative view" may show why there is no need for the Courts nor the Ombudsman to do so.

POLICY WORDING DISPUTES IN DOUBLE INSURNACE AND CONTRIBUTION CLAIMS

by Roger Doulton, Winward Fearon & Co.

I Introduction

The common law permits an assured to insure any subject matter in which he has an insurable interest as many times, and under as many policies, as he wishes.(1) When he does so he is said to have taken out double insurance although in the context of that renowned anti-hero of the recession, Johnny Fraud, seeking to recover indemnity from as many insurers as possible in respect of the same loss, 'multiple insurance' may often, perhaps, be a better description.

At first sight the law's apparent leniency in this respect might well encourage further propagation of what we lawyers choose to call the myth (but which the public knows to be the reality) that the law is an ass were it not for that equally uncomfortable other phenomenon of the recession, the insolvent insurance company! The law has always taken the view that an assured should be entitled to hedge against the risk of one of his insurers becoming insolvent – a risk which recent times have sadly only served to show to be very real indeed.