Privy Council Appeal No. 2 of 1994

Colonial Mutual General Insurance Company Limited *Appellants*

v.

ANZ Banking Group (New Zealand) Limited *Respondent*

FROM

THE COURT OF APPEAL OF NEW ZEALAND

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, Delivered the 27th June 1995

Present at the hearing:-

Lord Goff of Chieveley
Lord Jauncey of Tullichettle
Lord Browne-Wilkinson
Lord Nolan
Lord Hoffmann

*[Delivered by **Lord Hoffmann**]*

This appeal concerns the entitlement of a second mortgagee to the proceeds of a fire insurance policy taken out by the mortgagor upon the mortgaged property. The ANZ Banking Group (New Zealand) Limited ("the bank") held a second mortgage over a house in Tauranga belonging to a Mr. and Mrs. Whittall. The first mortgagee was a company administered by their solicitors, Messrs. Sharp Tudhope and Co., which had procured them an advance of $25,000 from another client.

By virtue of section 78 of the Property Law Act 1952 there was implied into the mortgage executed by the Whittalls in favour of the bank, "except in so far as the same are varied or negatived in the mortgage or by deed", certain covenants by the mortgagors of which the following are material:-

> " (2) That the mortgagor will forthwith insure and, so long as any money remains owing on the security, will keep insured against loss or damage by fire, all buildings and erections for the time being situate on the land described in

> the mortgage; the insurance to be effected in the name of the mortgagee, and in some insurance office in New Zealand to be approved by the mortgagee, and to be for the full insurable value of such buildings and erections as aforesaid; and will deliver the policy or policies of insurance, or cause the same to be delivered, to the mortgagee, who shall be entitled to the exclusive custody thereof; and will duly and punctually pay all premiums and sums of money necessary for the purpose of keeping every such insurance on foot; and will, not later than the forenoon of the day on which any premium falls due, deliver or cause to be delivered the receipt therefor to the mortgagee.
>
> ...
>
> (13) That compliance with the provisions of any mortgage having priority to this present mortgage which relate to insurance against loss or damage by fire shall be deemed, so far as it extends, to be compliance with any provisions as to the like insurance contained or implied in this present mortgage."

Clause 5 of the Memorandum of Mortgage executed by the Whittalls on 14th October 1986 did not negative the implication of these covenants. It expressly affirmed the implication of clause (2) by making certain variations to the statutory wording which are not for present purposes relevant. But to make assurance doubly sure, clause 5 also contained a separate express insurance obligation:-

> "The Mortgagor will insure all buildings fixtures and other improvements which shall for the time being be erected on the said land which shall be of a nature or kind capable of being so insured against fire in their full value and against such other risks (including earthquake risk in addition to or in substitution for or in the absence of any insurance under The Earthquake and War Damage Act 1944) as the Bank may from time to time require in the name of the Bank and the Bank alone shall have the power to settle compromise and recover that claim against any insurance company."

The bank instructed the Whittalls' solicitors, Messrs. Sharp Tudhope & Co., to act on its behalf in connection with the execution of the mortgage. In this capacity the solicitors certified the title and gave various undertakings in the bank's standard form, including the following as to the insurance:-

> "The building on the said property are (sic) insured as specified below for all appropriate risks including storm or flood damage. The policy has been or will immediately be assigned and the interest of the Bank as mortgagee has been

> or will be immediately noted with the Insurance Office so that the policy is in the name of the mortgagor and the mortgagee for their respective rights and interests."

The particulars specified below were of a policy with the State Insurance Office expiring on 19th February 1987. It made no reference to the person in whose name the policy had been effected but it was in fact Mr. Whittall. When the policy expired, Mr. Whittall transferred his custom to the defendants, the Colonial Mutual General Insurance Company Limited ("CMG"). Again the policy was effected in his own name. In August 1987 he produced to the bank a certificate of insurance from CMG which gave particulars of the policy and under the heading "Other Parties Interested in the Insurance" referred only to Messrs. Sharp Tudhope and Co. as first mortgagees. So on 30th September 1987 the bank wrote CMG a letter in its standard form:-

> "Insured: Mr. and Mrs. T. W. Whittall
> Address of Property: 43 Mansells Rd Greerton Tauranga
>
> [The bank] has an interest as 2nd mortgagee over the property covered by the above policy and we would appreciate our interests being noted in your records."

This produced a new certificate dated 15th December 1987 which was sent to the bank. This time, under the heading "Other Parties Interested in the Insurance", the bank appeared as second mortgagee.

On 25th February 1988 the house was destroyed by fire. In April 1988 the first mortgagees exercised their power of sale, repaid themselves out of the proceeds and handed over the balance, some $15,000, to the bank. This left the bank with a shortfall of about $73,000 secured by the second mortgage. So it claimed the proceeds of the insurance policy. It had written to CMG immediately after the fire to "register our claim under the policy in our capacity as second mortgagee". On 10th May 1988 the bank made a formal claim for the full amount of the insurance cover. But Mr. Whittall claimed that he was entitled to be paid the money instead. He seems to have been very persuasive because on 31st August 1988 CMG paid him $53,000 in full and final settlement. In these proceedings the bank claims that it was entitled to the policy monies and that CMG has not been discharged by its payment to Mr. Whittall. Gallen J. found for the bank. He held that clause 5 had the effect of assigning to the bank an interest in both the original State Insurance policy and the CMG policy which had replaced it. By asking for its interest to be noted, the bank had given notice of this assignment and by its certificate of insurance CMG had acknowledged the existence of the bank's interest. The Court of

Appeal approached the matter as an assignment of the proceeds of the CMG policy rather than an interest in the policy itself, but agreed that clause 5 had effected such an assignment and that CMG had been given notice.

Before their Lordships' Board Mr. Ring, for CMG, submitted an attractive argument that although the intention of clause 5 was to give the bank an interest in the insurance policy, it did not operate by way of assignment. The obligation to insure "in the name of the Bank" or (in the words of the parallel clause (2) in the Fourth Schedule to the Property Law Act 1952 "in the name of the mortgagee") showed that the bank was to obtain its interest as the original insured, on behalf of whom the mortgagor took out the policy. This is inconsistent with an assignment of an interest in a policy effected by the mortgagor in his own name. If the bank did not insist on strict compliance with the provisions of clause 5, it could not retrieve the situation by making the clause do duty as an assignment.

The Court of Appeal acknowledged the force of this argument in relation to an assignment of an interest in the policy. But it held that the concluding words "and the bank alone shall have the power to settle compromise and recover any claim against any insurance company" were not restricted to claims on policies effected in the name of the bank in accordance with the first part of the clause. They operated to assign an interest in the proceeds of <u>any</u> claim on <u>any</u> policy of insurance of the mortgaged property.

Their Lordships would be inclined to put the matter upon a broader basis. The purpose of a covenant for insurance is to ensure that if the value of the security should be depreciated by the occurrence of a fire or other insurable risk, the proceeds of the policy will provide a fund to make up the shortfall. This purpose can be achieved only if the covenant gives the mortgagee an interest by way of charge, and no more than an interest by way of charge, in the proceeds.

Standard insurance covenants contain various provisions designed to ensure that the mortgagee will be able to retain control of the insurance policy and its proceeds. Insisting that the mortgagee have the right to approve or nominate the insurer, take custody of the insurance policy, be shown receipts for premiums (all of which are in clause (2) of the Fourth Schedule) are some of the cumulative techniques used for this purpose. So is the requirement that the insurance be effected in the name of the mortgagee. But all these provisions are, in their Lordships' view, intended to <u>protect</u> the mortgagee's interest by way of charge over the proceeds of the policy rather than to create it. That such an

interest exists is a fundamental assumption of the covenant. It cannot be destroyed by the mortgagor's failure to comply with one or other of the protective terms.

If the policy is effected in the name of the mortgagee, he is entitled in law to payment of the proceeds. But his interest remains by way of charge to secure the mortgage debt and he will be accountable to subsequent mortgagees or the mortgagor for any surplus. If the policy is effected in the name of the mortgagor, the mortgagee still has an interest by way of charge in the proceeds. How as a matter of legal analysis does this interest take effect? Necessarily by way of assignment. A charge on a fund belonging at law to someone else operates as a partial equitable assignment: see *Durham Brothers v. Robertson* [1898] 1 Q.B. 765, 769. It is subject to the rule in *Dearle v. Hall* (1828) 3 Russ. 1 as to notice to the debtor in the same way as any other equitable assignment. On giving such notice, the mortgagee's interest as assignee is protected.

Their Lordships think that this approach is supported by clause (13) of the Fourth Schedule. In the case of the second mortgage, the insurance required by the first mortgage is to suffice. But the policy will not have been effected in the name of the second mortgagee. In such a case, the only way in which the insurance covenant can confer any benefit upon a second mortgagee as such is if it operates by way of assignment to create a charge (subject to the first mortgage) upon the proceeds of the policy. This must therefore have been what the covenant was intended to do.

Mr. Ring submitted in the alternative that the request to CMG to note the interest of the bank did not amount to notice of the assignment. Such notice need not be in any particular form. As Lord Macnaghten said in *William Brandt's Sons & Co. v. Dunlop Rubber Company, Limited* [1905] A.C. 454, 462:-

> "The language is immaterial if the meaning is plain. All that is necessary is that the debtor should be given to understand that the debt has been made over by the creditor to some third person."

See also *James Talcott Ltd v. John Lewis & Co. Ltd.* [1940] 3 All E.R. 592. Mr. Ring says that the bank did no more than ask CMG to note its interest as second mortgagee in the property. This was consistent with explanations other than it having acquired an interest by way of assignment in the proceeds of the policy. For example, it might simply have wanted to give CMG the opportunity to let it know if the policy was likely to be cancelled for non-payment of premiums.

Their Lordships think that these explanations are improbable and unreal. It is standard practice for mortgagees to ask for their interests to be noted and no one doubts that the purpose is to protect their interests in the policy proceeds. This was how CMG itself treated the notice: the certificate of insurance recorded the bank as "interested in the insurance". Since the policy was in the name of Mr. Whittall and the bank could, for the reasons explained, only have obtained an interest in the insurance as assignee, CMG were treating the request as notice of assignment. Their Lordships think that in the context of a notice to an insurance company by a mortgagee of the insured property, the language was plain and unambiguous. They will therefore humbly advise Her Majesty that the appeal should be dismissed. The appellant must pay the bank's costs before their Lordships' Board.