Minnesota Loss Payable Clauses in Fire Insurance Policies: Falling Short of the Minimum Coverage Requirements

William A. McNab

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MINNESOTA LOSS PAYABLE CLAUSES IN FIRE INSURANCE POLICIES: FALLING SHORT OF THE MINIMUM COVERAGE REQUIREMENTS

William A. McNab†

I. INTRODUCTION ........................................................................... 557

II. LOSS PAYABLE CLAUSES .......................................................... 559
   A. Historical Development .......................................................... 560
   B. The Contract Analysis Approach ............................................ 562
   C. The Statutory Analysis Approach ............................................ 568
   D. Recent Cases and Holdings .................................................... 569
      1. Other Jurisdictions ............................................................. 569
      2. Minnesota ..................................................................... 571
   E. The Current State of the Law in Minnesota .............................. 574

III. INNOCENT CO-INSUREDS ........................................................ 577
   A. Historical Development .......................................................... 578
   B. The Contract Analysis Approach ............................................ 581
   C. The Statutory Analysis Approach ............................................ 586
      1. Other Jurisdictions ............................................................. 586
      2. Minnesota ..................................................................... 589
   D. The Current State of the Law in Minnesota .............................. 591

IV. ARGUMENT FOR SIMILAR TREATMENT OF MORTGAGEES ...... 594

V. CONCLUSION ............................................................................. 599

I. INTRODUCTION

Many real properties are mortgaged.¹ Most of these mortgaged properties are insured.² There is no mystery to either of these propositions. However, the relationship between the two can be somewhat mystifying at times, giving rise to questions about the rights and duties of insureds, insurers and lenders.³ Most banks and other lending institutions


2. See id.
3. See Stephen E. Goldman, Rethinking the Mortgagee’s Position: Should the
require that borrowers obtain insurance on the mortgaged property to protect against various perils and risks. In most cases, the borrower or mortgagor will obtain the required policy in her or his own name and simply identify others (e.g., bankers, lenders and mortgagees) as secured parties or parties with an insurable interest in the property.

In the event of fire, hail, tornado or a host of other perils, the insured can make a claim against the insurer and receive the proceeds of the policy. From these proceeds, one can make repairs or, in the case of a total loss, pay down the mortgage and begin anew. But what happens if the insured himself becomes the source of the peril? Arson and other insurance frauds are commonplace occurrences. Of course, most insurance policies deny coverage when the loss is caused by the insured's intentional acts. But where does this leave the lender or mortgage holder? Because the property itself was the security for the loan, and the borrower has been denied coverage, the lender now may be vulnerable. Similarly, what happens to other named insureds that have an interest in the now-damaged property? If the proceeds of the policy have been denied due to the fraudulent act of one insured, what rights, if any, do other co-insureds have to the benefits of the policy?

Courts throughout the United States and Great Britain have wrestled with these questions for centuries. The resulting body of law is not al-

4. See Steinmetz et. al, supra note 1, at 81.
6. See George Richards, Richards on the Law of Insurance 1-2 (Rowland H. Long ed., 4th ed. 1932); see also 1 Insuring Real Property § 1.03[1], at 1-12 (Stephen A. Cozen ed., 1999) (noting that nearly any type of risk can be insured against, save those limited by public policy restraints).
7. See generally 12 George J. Couch, Couch on Insurance § 176:59 (Lee R. Russ & Thomas F. Segalla eds., 3d ed. 1997) (describing insured’s options to repair or rebuild as based on express policy language and intent of the parties to the contract).
9. See 1 Insuring Real Property, supra note 6, § 1.03[1], at 1-13; see also Committee on Property Ins. Law Tort and Ins. Practice Section, Annotations of the 1943 New York Standard Fire Insurance Policy and Extended Coverage Endorsement 89-108 (2d ed. 1994). According to the committee report, virtually every state in the U.S. has a statutory fire insurance policy that provides exceptions for arson and other forms of fraud, misrepresentation and concealment by the insured. See id.
10. See generally Joshua Stein, Property Insurance: Lender’s Hot Buttons in Loan Closings and Administration, 442 PLI/REAL 725, 739 (1999) (noting the potential risks to lenders of finding themselves unprotected against damage to their secured interests).
11. See 1 James Oldham, The Mansfield Manuscripts and the Growth of
ways clear or consistent. However, the combined efforts of the Minnesota State Legislature and the Minnesota Supreme Court recently have made progress in this regard. This article explores the evolution of property insurance law and the resulting duties and obligations of insurers, mortgagors and mortgagees. This article also reviews recent developments in innocent co-insured law. Finally, this article argues that the reasoning used by the Minnesota Supreme Court to protect innocent co-insureds in Watson v. United Service Automobile Ass'n should be applied to similarly protect innocent lenders when mortgagees commit arson.

II. LOSS PAYABLE CLAUSES

While the earliest forms of public fire insurance have existed since the Middle Ages, it was not until after the Great Fire of London in 1666 that private fire insurance policies began to resemble modern policies. The early policies were patterned after existing maritime and inland marine insurance models. The form and legal standing of such policies further evolved under the guidance of Lord Mansfield, a leader in the development of commercial law in England. The first fire insurance companies were established in the New World as early as 1735. The Philadelphia Contributorship for Insurance of Houses By Loss of Fire, which Benjamin Franklin helped create in 1752, operates to this day.

Many principles of contemporary fire insurance are recognizable in those early policies, albeit in rudimentary form. Then, as now, policies included exclusions for fires caused by “usurped power” or “civil commo-
The insured then and now must have an insurable interest in the subject property. Of particular long-term significance, under Lord Mansfield, the courts came to view the insurance contract as *uberrimaefidei*, requiring utmost fidelity between the parties. These principles crossed the Atlantic with the colonists and remain fundamental precepts of modern American insurance law.

A. Historical Development

Because many insured properties are encumbered by mortgages or other security agreements, fire policies typically afford some level of protection of the secured party's interest. In early instances, mortgagees took out independent policies upon subject properties and paid premiums directly to the insurer. This method of protection proved problematic, for several reasons: 1) mortgagees preferred not to absorb the additional cost of premiums; 2) mortgagees often lacked control over the subject property and hence could not ensure that the conditions of insurance were met; and 3) mortgagors generally could not receive any benefit from such policies.

Mortgagees then began requiring that mortgagors obtain insurance on the property with an assignment of the proceeds back to the mortgagee. This assignment came to be known as the loss payable clause. Over time, loss payable clauses have been referred to alternatively as the open mortgage clause, simple mortgage clause or the simple loss payable clause. The assignment of loss payee status generally was established by a designation on the declaration page or an endorsement to the policy indicating that a loss, if any, was payable to the loss payee, as its interests ap-

26. See 1 Insuring Real Property, *supra* note 6, § 1.03[1], at 1-13 (describing the requirement of insurable interest). See generally William T. Barker et al., *Is an Insurer a Fiduciary to Its Insureds? 25 Tort and Ins. L.J. 1, 1-2 (1989) (asserting that while insurers are not always required to act solely in best interests of the insured and are not held to the strictest meaning of fiduciary, they must comport with principles of good faith and fair dealing).
28. See Richards, *supra* note 6, at 467-68.
29. See id. at 471.
30. See id. at 472; Steinmetz et al., *supra* note 1, at 81-82.
31. See Steinmetz et al., *supra* note 1, at 81; see also Dwyer & Barney, *supra* note 27, at 2.
32. See 4 Couch, *supra* note 7, § 65:8.

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The loss payable clause also was problematic for mortgagees. As a mere appointee of the insured mortgagor, the mortgagee’s rights were purely derivative. As such, the mortgagor was subject to the same defenses and policy conditions as the insured mortgagor. Thus, if the policy was void due to an act of the insured such as fraud or arson, it also was void as to the mortgagee loss payee.

Because the loss payable clause still carried more risk than many lenders were willing to assume, a new form of the mortgage clause evolved in the latter part of the nineteenth century. Now, this form is referred to as the standard, union or mortgage clause. In 1894, the Eighth Circuit Court of Appeals became the first court to judicially review the standard mortgage clause. In its decision, the court discussed both the differences between simple and standard mortgage clauses and the rationale underlying the evolution of the standard form:

We all know that [twenty] years ago a contract between a mortgagee and an insurance company, like that before us, was novel and rare. At that time the customary method of indemnifying the mortgagor against loss by fire was to indorse upon the policy the words, “Loss, if any, payable to . . . mortgagee, as his interest may appear,” or words of similar import. Today such an indorsement is rare, and a contract similar to the mortgage clause before us is in general use. Why this change? The reason is not far to seek. The old endorsement made the mortgagee a simple appointee of the mortgagor, and put his indemnity at the risk of every act or neglect of the mortgagor that would avoid the original policy in his hands. Indemnity so precarious, so liable to be destroyed by the ignorance, carelessness, or fraud of the mortgagors, was not satisfactory to the mortgagees; and they proceeded to make contracts with the insurance companies

33. See id.; see also 5A JOHN ALAN APPLEMAN & JEAN APPLEMAN, INSURANCE LAW AND PRACTICE § 3401 (1970); 3 INSURING REAL PROPERTY, supra note 6, § 52.01; Steinmetz et. al., supra note 1, at 82.
34. See 3 INSURING REAL PROPERTY, supra note 6, § 52.01.
35. See 3 id.
36. See 46A C.J.S. Insurance § 1404 (1993); 4 COUCH, supra note 7, § 65:24; 3 INSURING REAL PROPERTY, supra note 6, § 52.01; RICHARDS, supra note 6, at 474.
37. See 45 C.J.S. Insurance §§ 595, 638 (1993); 4 COUCH, supra note 7, § 65:24; 3 INSURING REAL PROPERTY, supra note 6, § 52.01; see also Steinmetz et. al., supra note 1, at 81-82 (stating that mortgagee’s interest can be voided by mortgagor’s neglect).
38. See Dwyer & Barney, supra note 27, at 3; Steinmetz et. al., supra note 1, at 82.
39. See Dwyer & Barney, supra note 27, at 3; Steinmetz et. al., supra note 1, at 82; 3 INSURING REAL PROPERTY, supra note 6, § 52.01.
similar to that before us, for the purpose of securing indemnity
to their interest that should not be affected by any act or negli-
gence of the mortgagors.\footnote{41}

Thus, lenders finally found a reasonable level of protection.\footnote{42} Other
courts soon recognized the standard mortgage clause as well.\footnote{43}

Courts consistently have held that the standard mortgage clause cre-
ates, in substance, two independent contracts of insurance: one between
the insured mortgagor and the insurer and another, completely separate
from the first, between the mortgagee and the insurance company.\footnote{44} In
this case, a breach of one or more policy conditions by the mortgagor may
preclude benefits as to the mortgagor, but it will not affect the independ-
ent contract rights of the mortgagee.\footnote{45} A mortgagor therefore can collect
the proceeds of the policy in spite of the wrongful or negligent acts of the
insured mortgagor.\footnote{46}

B. The Contract Analysis Approach

Courts have looked to the language of the policy to determine if the
mortgage clause is simple or standard in form.\footnote{47} Some standard mortgage
clauses expressly provide that the mortgagee's rights "shall not be invali-
dated by any act or neglect of the mortgagor or owner of the within de-
scribed property."\footnote{48} Because they form an independent contract, stan-
dard mortgage clauses also may create a duty upon the insurer to notify
the mortgagee of intent to cancel the policy.\footnote{49} More recently, many short-
form or "easy read" standard mortgage clause contracts exclude the for-
mer language and courts interpret them as standard clause contracts
solely on the basis of the language indicating that the insurer has a duty to

\footnote{41} Id. at 173-74 (citation omitted).
\footnote{42} See 3 INSURING REAL PROPERTY, supra note 6, § 52.01.
\footnote{43} See Piedmont Fire Ins. Co. v. Fidelity Mortgage Co., 35 So. 2d 352, 353
(Ala. 1948); Commercial Sec. Co. v. Central Sur. & Ins. Corp., 29 So. 2d 712, 715
(La. Ct. App. 1947); H.F. Shepherdson Co. v. Central Fire Ins. Co., 220 Minn. 401,
401-02, 19 N.W.2d 772, 773 (1945); B.X. Corp. v. Aetna Ins. Co., 63 N.Y.S.2d 14, 18
(N.Y. Sup. Ct. 1946); Third Nat. Co. v. Thompson, 191 S.W.2d 190, 192-93 (Tenn.
\footnote{44} See Steinmetz et al., supra note 1, at 83; see also 46A C.J.S. Insurance § 1404
(1993); 5A APPLEMAN & APPLEMAN, supra note 33, § 3401; 4 COUCH, supra note 7, §
65:93; 3 INSURING REAL PROPERTY, supra note 6, § 52.01.
\footnote{45} See Steinmetz et al., supra note 1, at 83 (citation omitted); see also 3
INSURING REAL PROPERTY, supra note 6, § 52.01.
\footnote{46} See Steinmetz et al., supra note 1, at 83.
\footnote{47} See 1 INSURING REAL PROPERTY, supra note 6, § 1.04[2][a], at 1-20.
\footnote{48} Steinmetz et al., supra note 1, at 83; see also 3 INSURING REAL PROPERTY,
supra note 6, § 52.01.
\footnote{49} See 3 INSURING REAL PROPERTY, supra note 6, § 52.01.
warn the mortgagee of its intent to cancel the policy.50

In either case, courts continue to look to the language of the contract to determine the type of mortgage clause included. When the courts find a provision that, as to the mortgagee, the policy will not be invalidated by any act of the insured, or they find a policy requirement of notice to the mortgagee of the insurer's intent to cancel, the courts will hold that the policy includes a standard mortgage clause.51 Conversely, when the mortgagee is identified merely as a loss payee, or the contract states only that losses are payable to the mortgagee as its interests may appear, courts have interpreted the contract to contain a simple mortgage clause.52 In virtually every jurisdiction, simple loss payees have been denied benefits when the policy was found void due to the acts or negligence of the insured.53

50. See Steinmetz et. al., supra note 1, at 85.
51. See 1 INSURING REAL PROPERTY, supra note 6, § 31.04[2][a], at 1-20.
52. See Steinmetz et. al., supra note 1, at 85.
53. See 45 C.J.S. Insurance §§ 595, 638 (1993); see also Delaware Ins. Co. v. Greer, 120 F. 916, 917 (8th Cir. 1903). The true construction of the clause is:

Loss, if any, payable to, mortgagee as his interest may appear; or of words of similar import, when attached to policies of fire insurance, is that the mortgagee thereby made the simple appointee of the mortgagor, and that his indemnity is at the risk of the acts and omissions of the latter mortgagor's interest under the original policy.

54. See Capital Fire Ins. Co. v. Langhorne, 146 F.2d 237, 243-44 (8th Cir. 1945). In Capital Fire Insurance Co., the court stated:

[W]here the insurance on the mortgaged property has been obtained by the mortgagor, loss payable to the mortgagee as his interest may appear, the insurer is not entitled to subrogation to the rights of the mortgagee on payment of the loss to him, in the absence of a provision to that effect in the policy. . . . In the absence of a subrogation clause in the policy of insurance payable to the owner and the mortgagee, as their interests may appear, a payment to the mortgagee is a payment pro tanto of the mortgage debt.

Id. In Aetna Insurance Co. v. Houston Oil & Transport Co., 49 F.2d 121, 124 (5th Cir. 1931), the court stated:
There is considerable conflict in the decisions on the question of recovery by mortgagees. Undoubtedly the clause may be so drafted as to make the loss payable to an assignee in any event, but such is not the case here. The rule supported by the weight of authority is that where the clause is in simple terms, as appears in the policy in suit, the assignee is merely appointed agent of the insured to receive the money and he is bound by any act of the insured that would forfeit the policy.

Id. In St. Paul Fire & Marine Insurance Co. v. Ruddy, 299 F. 189, 196-97 (8th Cir. 1924), the court stated:

We think it the almost universal voice of authority that under such a clause the mortgagee recovers only on the theory that he is the appointee of the insured to receive the money, or a portion thereof. If the insured cannot recover, he cannot recover. Smith & Bernard, original mortgagors, cannot recover, as they have parted with their insurable interest. Iverson cannot recover, if he has likewise parted with his insurable interest. Ruddy cannot recover, for the reasons we have hereinbefore set forth. Hence the mortgagee cannot recover.

Id.; see also Delaware Ins. Co. v. Greer, 120 F. 916, 921 (8th Cir. 1903) (finding that "insurance of a mortgagee under the customary clause, which reads, in substance, '[l]oss, if any, payable to . . . mortgagee as his interest may appear,' ceases if foreclosure proceedings are instituted against the mortgagor, and the latter knows that they have been commenced, at any time before the fire which causes the loss occurs").

States such as Alabama, California, Florida, Georgia, Illinois, Iowa, Kansas, Kentucky, Minnesota, Missouri, Montana, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Tennessee, Texas, Vermont, Virginia, and Wisconsin have also held similar propositions. See, e.g., London & Scottish Assurance Corp. v. Smith, 158 So. 892, 894 (Ala. 1935) ("A forfeiture by reason of complete change of ownership without the consent of the insurer, so that the policy is no longer in force in favor of the insured, defeats also the claim of his appointee."); Southwestern Funding Corp. v. Motors Ins. Corp., 378 P.2d 361, 363 (Cal. 1963). In Southwestern Funding Corp., the court stated:

However, it is our view that on the record before us and we consider both its affirmative and its negative aspects; i.e., the stipulated facts and plaintiff's failure to show the language of the loss payable clause in its favor we cannot hold that as a matter of law the evidence is not sufficient to support the trial court's findings and conclusions in favor of Motors Insurance. For all that appears, the policy provided merely that the loss would be payable to the lienholder as his interest might appear. The courts are practically unanimous in holding that such a clause gives the beneficiary thereof no greater right of recovery than that of the insured.

Id.; see also Southern Ins. Co. v. First Nat'l Bank, 237 So. 2d 302, 303 (Fla. Dist. Ct. App. 1970) ("[W]hile the mortgagee's right of recovery under an indorsement on a policy issued to the mortgagor containing a simple mortgage clause making the loss payable to the former may be defeated by any breach of conditions by the insured before the loss occurs, it cannot be defeated by an act of the insured after the loss has occurred."); Brooker v. American Ins. Co., 16 S.E.2d 251, 254 (Ga. Ct.
LOSS PAYABLE CLAUSES

App. 1941). In *Brooker* the court found that the sale of the truck by the assured "was a violation of the title and ownership" clause of the policy, and further, that:

Unless such sale and transfer of title was agreed to in writing by the insurer and this agreement added to the policy or unless the company consented thereto and there has been a waiver of such written agreement to the sale of the property by the assured by an authorized agent of the insurer or an estoppel in pais relative thereto, the policy was rendered void by the sale of the truck by the assured, divesting herself of any insurable interest therein.

*Id.* In *Barwick v. Westchester Fire Insurance Co.*, 266 Ill. App. 574, 575 (1932), the court recognized:

[I]t has been uniformly held that a loss payable clause, such as the one in question, places the indemnity of the appointee at the risk of every act and omission of the assured that would void, terminate or adversely affect the insurance of the latter's interest under the policy, and that if the assured is guilty of some breach of the covenants or clauses of the contract, which the policy stipulates shall avoid the insurance, so that the loss is not collectible by him, it likewise will prevent the appointee from recovering upon the loss payable clause.

*Id.; see also* Carlile v. Home Mut. Ins. Ass'n, 254 N.W. 805, 806 (Iowa 1934) (finding that "[b]y the terms of the policy, which were specifically made applicable to plaintiffs by the loss payable clause, recovery could not be had for damage caused through design of (building owner)"; Elmore v. Royal Ins. Co., 114 P.2d 786, 790 (Kan. 1941) ("The instant contract contains no exception which provides that the insurer shall be liable to the mortgagee if the mortgagor commits an act of forfeiture after the loss occurs. In order for appellant to prevail we must read such an exception into the contract. This[,] courts are not permitted to do . . . ."); Farmers & Depositors Bank v. Commonwealth Ins. Co., 226 S.W.2d 773, 774 (Ky. 1950) ("A breach of any condition of the contract by the assured owner that would prevent recovery by him precludes recovery from the insurance company by the mortgagee as his mere appointee to receive the money to the extent of its interest in the mortgaged property."); State Sav. Bank v. Shible Mut. Fire Ins. Co., 172 Minn. 122, 124-26, 214 N.W. 926, 927-28 (1927) ("Owner's sale of property without consent of township mutual fire insurance company held to prevent mortgagee from collecting insurance, regardless of statute . . . ."); Ford v. Iowa State Ins. Co., 298 S.W. 741, 746 (Mo. 1927) ("It is regrettable that in this case the holders of bona fide indebtedness should suffer because of the misdeed of an owner of the property, but the mortgagee's interest being insured subject to a condition of the policy covering this contingency, the insurer is not liable on breach of condition."); Ramsey v. Farmers' Mut. Ins. Co., 139 S.W.2d 1027, 1029 (Mo. Ct. App. 1940) (finding that "the policy became void as to insured because of the commencement of foreclosure proceedings, it is also void as to the mortgagee who claims under an open mortgage clause and whose rights are no greater than those of insured"); Malvaney v. Yager, 54 P.2d 135, 138-39 (Mont. 1936). *In Malvaney*, the court held:

Under such a mortgage clause, if loss occurs while the mortgage is in full force and after the debt is due, the mortgagee is bound to collect the insurance money and apply it in full, or pro tanto, satisfaction of the debt,
and such payment amounts to satisfaction of the mortgage to the extent of the payment; and if the mortgage debt be not due at the time of loss and payment, the mortgagee shall hold the insurance money to discharge the debt or payments as they fall due.

Id. (citation omitted) In Highway Trailer Co. v. Donna Motor Lines, Inc., 217 A.2d 617, 621 (N.J. 1966), the court stated:

We hold that where, as here, the insurer knows that the loss payee of a theft insurance policy has a vital interest in the claim and by its conduct leads the loss payee reasonably to believe that the claim has been adequately presented, thereby lulling the loss payee into inaction, the insurer is estopped from asserting any defect in the presentation of that claim.

Id.; see also Hessian Hills Country Club, Inc. v. Home Ins. Co., 186 N.E. 439, 441 (N.Y. 1933) (“Where, however, the contract of insurance is with the mortgagor, and the undertaking to pay the loss to the mortgagee is collateral and dependent upon the principal undertaking, the mortgagee cannot recover if there has been a breach of condition of the policy by the mortgagor.”); Wiggins v. Sun Underwriters Ins. Co., 146 S.E. 216, 218 (N.C. 1929) (“Upon all the evidence, plaintiffs were not entitled to the equitable remedy of reformation of the policy. Without a reformation, we think it clear that they cannot recover on the policy.”); New Jersey Ins. Co. v. Ball, 165 N.E. 41, 43 (Ohio 1929) (“Condition in fire policy voiding insurance if other insurance covers risk held reasonable, unambiguous, and enforceable.”); Haskin v. Greene, 286 P.2d 128, 138 (Or. 1955). In Haskin, the court stated:

We think it unnecessary to set out the provisions which are relied on by respondent’s counsel and that it is sufficient to call attention to the following language appearing on the face of the policy: Assignment of this policy shall not be valid except with the written consent of this company. There is no claim that any such consent was ever obtained.

Id. In General Electric Credit Corp. v. Aetna Casualty & Surety Corp., 263 A.2d 448, 454 (Pa. 1970), the court stated:

The fire in this case was the result of arson by the owners (Tasso and George Chronis) of the named insured (Silver Spur Company). . . . The insurance companies are therefore not liable to the insured. In the absence of a stipulation in the policy giving to a creditor, who is made a beneficiary-payee in the policy, higher rights than the insured owner, the creditor's right to proceeds under the policy is derivative and limited to the extent of the insured's right of recovery. Therefore, unless GECC can come within some provision in the two policies involved protecting it despite any act or neglect of the insured, it will be precluded from recovery under these policies.

Id. In Central National Insurance Co. v. Manufacturers Acceptance Corp., 544 S.W.2d 362, 364 (Tenn. 1976), the court stated:

[T]hat the policy provisions, when coupled with the covenant by the in-
The significance of this distinction hardly can be overstated, because
in cases of arson, fraud, concealment or misrepresentation, the mort-
gagee’s rights under the policy will rise or fall with the determination of
the type of mortgage clause in the contract.\footnote{See \textit{3 Insuring Real Property, supra} note 6, $\S$ 52.02[3].} The protection afforded
mortgagees under the standard mortgage clause is remarkably broad.\footnote{See \textit{supra} note 55 and accompanying text.} The clause indemnifies the mortgagee against specified perils, impermis-
sured in the chattel mortgage that he would keep the motorcycle insured
against loss by theft and that such loss, if any, should be payable to the
mortgagee, gave the mortgagee the right to receive the proceeds of the
policy to the extent of the debt owed by the mortgagor to the mortgagee
at the time of the loss; but that where the policy did not contain a union
mortgage clause, protecting the interest of the mortgagee from acts or
omissions of the insured mortgagor which, under the terms of the policy,
could operate to invalidate the coverage, the insured’s failure to file a
sworn proof of loss and refusal to respond to repeated requests of the in-
surer that he make himself available for discussion of the alleged loss
barred the mortgagee from recovering on the policy.

\textit{Id.} In \textit{Travelers Indemnity Co. v. Columbus State Bank}, 442 S.W.2d 479, 480 (Tex. Civ. App. 1969), the court recognized:

\begin{quote}
Where [the] policy stated that endorsements formed part of policy and
reference was made to endorsement, not attached to policy, which ex-
cluded coverage while automobile was being operated by mortgagor, and
endorsement was issued with intention on part of insurer and mortgagor
that it be part of policy, as between insurer and mortgagor endorsement
was validly included in policy and mortgagee could not recover under
loss payable clause for damage to automobile while it was being driven by
mortgagor.
\end{quote}

\textit{Id.; see also} Vermont Mut. Fire Ins. Co. v. Van Dyke, 165 A. 906, 907 (Vt. 1933) (finding that mortgagee was merely insured’s appointee, and insured’s fraud pre-
cluded mortgagee from suing insurer); New Brunswick Fire Ins. Co. v. Morris Plan
Bank, 118 S.E. 236, 238 (Va. 1923) (holding that “[t]he right of the plaintiff here
is entirely derived from the assured Toler and it is clear to us that the contract has
been avoided by his action because of the additional insurance which he took out
in the National Union;” therefore, judgment in favor of defendant company). Fi-
(Wis. 1934), the court stated:

\begin{quote}
The failure of the plaintiff to provide by contract for the restoration in
the event of the destruction of the property by fire by applying the pro-
ceds of the insurance puts it in a very disadvantageous position. The
court cannot by way of construction or in the exercise of equity power
remake the contract to fit the situation that now exists.
\end{quote}

\textit{Id.; cf.} Wells Fargo Bank Int’l Corp. v. London S.S. Owners’ Mut. Ins. Ass’n., 408 F.
Supp. 626, 629 (S.D.N.Y. 1976) (staying proceedings pending arbitration, in lieu
of directly denying benefits).
sible acts or negligence of the insured mortgagor and some acts of the in-
sured, such as policy cancellation. Examples of acts which, under the
standard mortgage clause, have been held void as to the insured but not
as to the mortgagor include: 1) arson or intentional destruction of prop-
erty; 2) fraud or misrepresentation; 3) non-permitted procurement of
other insurance; 4) alienation of title or change of occupancy; 5) foreclo-
sure or initiation of foreclosure proceedings; 6) deed by mortgagor to
mortgagor in lieu of foreclosure; 7) increase of hazard; and 8) non-
payment of premium. Even more indicative of the reach of standard mortgage clauses are
the many decisions holding that even material misrepresentations by
the insured prior to or at the inception of the contract do not void the policy
ab initio as to the mortgagee. By contrast, the simple loss payable mort-
gage clause is as limited as the conditions and exclusions of the policy.

C. The Statutory Analysis Approach

By statute, the New York Standard Fire Policy specifies the form and
substance of fire insurance policies in that state. In 1943, the New York
Legislature amended the statute to include a version of the standard

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57. See Dwyer & Barney, supra note 27, at 12.
58. See id. at 13-15.
59. See 3 INSURING REAL PROPERTY, supra note 6, § 52.01, (stating that such rep-
resentations "merely serve to abrogate coverage under the policy as to the mortga-
gor"); see also National Commercial Bank & Trust Co. v. Jamestown Mut. Ins., 334
N.Y.S.2d 1000, 1000-01 (N.Y. App. Term. 1972); Young Men's Lyceum v. National
"[t]he words of the clause 'loss shall be payable,' amount to a waiver by the
company, in favor of the mortgagee, of the effect of any prior or contemporaneous
act of the owner which would have a vitiating effect upon the policy") (emphasis
added). In Imperial Building & Loan Ass'n v. Aetna Insurance Co., 166 S.E. 841, 842
(W. Va. 1932), the court stated:

We think the mortgagee, when a policy is presented to him with a stan-
dard mortgage clause attached thereto in his favor, is justified in assum-
ing that the insurance company has satisfied itself that the policy is valid
and free from impeachment for any conduct or act of the assured at its
inception or prior to the attachment of the mortgage clause.

Id. (citing Germania Fire Ins. Co. v. Bally, 173 P. 1052 (Ariz. 1918)).
60. See 3 INSURING REAL PROPERTY, supra note 6, § 52.01. Because a mortgagee
under a simple loss payable clause merely stands in a position derivative of the
rights of the insured, he is controlled by the same policy exclusions and limitations
as the insured. See 3 id.
61. See COMMITTEE ON PROPERTY INS. LAW TORT AND INS. PRACTICE SECTION, su-
pra note 9, at 3 (providing a chart that gives the "manner by which the policy has
become standard" in different jurisdictions).
mortality clause. By 1951, every state in the U.S. enacted similar legislation, either requiring, or at the very least recommending, the use of some version of the standard fire insurance policy. Today, ten states still use the 1943 version of the New York Standard Fire Insurance Policy. Other states have amended the form slightly, usually in style and layout.

Some states, including Minnesota, include within their standard fire insurance forms an express statement that: "if this policy shall be made payable to mortgagee... no act of any person other than such mortgagee... shall render this policy void as to such mortgagee..." Other states, such as New York, simply state that, "if this loss hereunder is made payable... to a designated mortgagee not named herein as the insured, such interest in this policy may be cancelled by giving to such mortgagee a ten days' written notice of cancellation."

Although this phrase is less express than the Minnesota form, this provision for notification of cancellation has been held sufficient to create the independent contract status necessary to indicate existence of a standard mortgage clause.

Thus, the standard mortgage clause is recognized and available in virtually all states. One commentator suggests that, "as a practical matter, the historical distinction between the simple loss payee reasoning, and the standard mortgage clause is declining in importance because mortgagees... are almost universally insured under standard mortgage clauses. However, a large body of case law, old and new, suggests otherwise.

D. Recent Cases and Holdings

1. Other Jurisdictions

The following examples of recent decisions in various state and federal courts interpreting loss payable clauses demonstrate that many jurisdictions continue to apply the traditional simple loss payee reasoning,
rather than standard mortgage clause reasoning in reaching their decisions. This reasoning frequently results in lenders finding themselves unprotected.

In 1992, a New York bank listed as "loss payee" and not as "insured" under policies insuring a consignor of gold bullion and jewelry was found not entitled to proceeds of policies after insured property was lost. The court ruled that, as a mere loss payee, the bank had no greater rights than the consignor, who was deemed to have perpetrated a scheme to defraud the insurance company.

In a 1983 decision, the Massachusetts Supreme Court held that a bank designated as a "loss payee" in a comprehensive policy issued to a debtor could collect only so long as suspected arson on the part of the insured could not be established.

The Louisiana Court of Appeals held in 1982 that a mortgagee named as "loss payee" in the policy could not recover its interests in the policy where the insured had settled independently with, and released from liability, third-party defendants who caused the loss.

As recently as 1998, the Missouri Court of Appeals denied coverage to the mortgagee of a sunken boat where the insured mortgagee misrepresented material facts to the insurer and the mortgagee bank had only a simple loss payable clause.

In 1976, a Tennessee bank named in the policy as "mortgagee" was unable to recover losses where the insured failed to file the required sworn proof of loss form. The court determined that despite the bank's designation as mortgagee, the policy contained a simple mortgage clause.

In 1972, the Hawaii Supreme Court ruled that a creditor named "loss payee" on the policy was unable to recover losses when the insured abandoned with the covered yacht.

These are but a few examples. Recent cases from nearly every jurisdiction indicate that, contrary to at least one commentator's suggestion, many policies for both real and chattel property continue to be written

71. See supra notes 53-54 and accompanying text.
73. See id. at 1479.
78. See id.
80. See Dwyer & Barney, supra note 27, at 3.
with simple loss payee mortgage clauses.  

2. Minnesota

Relatively few Minnesota cases have addressed the wrongful acts of insureds as they affect the rights of innocent mortgagees. Nonetheless, a careful review of the decisions suggests that the simple loss payee form exists, at least in theory, in Minnesota.

A frequently cited Minnesota decision is *Allen v. St. Paul Fire & Marine Insurance Co.*, from 1926. In this case, the court set the stage for future judicial review of loss payable clauses when it considered whether the purchase of other insurance by the insured (contrary to the conditions set forth in the policy) voided the policy as to the mortgagee. The court found language within the contract that indicated that no act of the insured would void the policy as to the mortgagee, and held that the policy contained a standard mortgage clause and ruled in favor of the lender. The court followed the general consensus view of simple and standard clauses, noting that while the standard mortgage clause creates an independent contract not voidable by the acts of the insured, the open (simple) loss payable clause makes the mortgagee a mere appointee to receive what otherwise would come to the mortgagor.

Little has changed in the ensuing seventy-three years. Minnesota courts continue to review contract language to determine if the loss payable clause is simple or standard. In the 1945 case of *H.F. Shepherdson Co. v. Central Fire Insurance Co.*, the Minnesota Supreme Court considered whether a previously terminated partnership between the mortgagor and mortgagee nullified the mortgagee's status under the standard mortgage clause. The insurance company argued that, as partners, the mortgagee and mortgagor were agents of each other and as such, the plaintiff mortgagor was bound by the fraudulent acts of the mortgagor. The court

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81. *See supra* notes 53-54; *see also* American Nat'l Bank & Trust Co. v. Young, 329 N.W.2d 805, 811 (Minn. 1983). In reviewing an appellate decision regarding the proceeds of an insurance policy on an airplane, the court explained that it could not find a basis in case law or in secondary sources indicating that the standard mortgage clause did not apply equally to chattel property and real property.  

82. *See infra* notes 83, 88, 92, 100.


84. *See id.* at 818.

85. *See id.*

86. *See id.*

87. *See infra* notes 88, 92, and 100.


89. *See id.* at 405, 19 N.W.2d at 774.
held for the mortgagee because the partnership had ended long before
the loss and ensuing claim. More significant is that the court followed
the lead of Allen and used a contract theory analysis to determine the na-
ture of the loss payable clause.

Continuing this trend and again relying heavily on Allen, the court in
American National Bank & Trust Co. v. Young, construed a breach of war-
ranty clause in an insurance policy as a standard mortgage clause. When
Young, the insured mortgagor, took the insured property to Colombia, he
breached stipulations of the breach of warranty clause and the territorial
limitations of the policy. The Colombian authorities confiscated the
plane for alleged drug trafficking. When the insurer challenged its li-
ability to the mortgagor, the court analyzed the language of the breach of
warranty clause, which read in part:

Loss, if any, under Coverage C shall be payable as interest may
appear to the lienholder named in Item 8 of the declarations
and this insurance as to the interest of the bailment lessor, con-
ditional vendee or mortgagee . . . shall not be invalidated by any
act or neglect of the lessee, mortgagor or owner of the within
described aircraft . . . Nothing herein contained shall be held
to vary, waive, alter or extend any of the terms, conditions,
agreements, or warranties of the below mentioned policy, other
than as above stated.

The insurer argued that the first portion of the clause was subordi-
nate to the second, resulting in a simple loss payee clause. The court dis-
agreed after analyzing the contract language and instead equated the
clause to the standard mortgage clause in the Minnesota Standard Fire In-
surance Policy. The court then discussed traditional simple and stan-

90. See id. at 407, 19 N.W.2d at 775.
91. See id. at 406, 19 N.W.2d at 775 (citing Allen v. St. Paul Fire & Marine Ins.
Co., 167 Minn. 146, 208 N.W. 816 (1926)).
92. See American Nat'l Bank & Trust Co. v. Young, 329 N.W.2d 805, 811
(Minn. 1983) (finding the insured property was an airplane).
93. See id. at 806.
94. See id.
95. Id. at 808.
96. See id. at 810.
97. See id. at 811. The court noted that the insurer's argument that the
breach of warranty clause was a form of hybrid open (simple) mortgage clause was
self-defeating. See id. The apparent contradiction between the first clause, written
in the language of a standard mortgage clause, and the second clause, which
stated that the former shall not vary, waive, alter or extend any of the other condi-
tions of the policy, was ambiguous. See id. The court chose to reconcile the dis-
crepancy by interpreting the second clause as referring to and limiting any sepa-
rate, later insurance issued to the mortgagee. See id. However, the court took
standard loss payee principles, quoting *Allen* at length.\(^98\) Ruling that the breach of warranty clause essentially was a standard mortgage clause, the court held that the acts of the mortgagor did not void the policy as to the mortgagee.\(^99\)

In *Northwestern National Casualty Co. v. Khosa, Inc.*, the Minnesota Court of Appeals ruled against a property owner named as a simple loss payee in a property insurance policy.\(^100\) Under the terms of the lease agreement, the tenant, Khosa, Inc., was to pay the real estate taxes on the property.\(^101\) When Khosa fell behind in making payments, the property owner, Tigner, brought an unlawful detainer action.\(^102\) On the evening prior to the unlawful detainer hearing, Khosa removed personal property and fixtures from the leased premises, resulting in significant physical damage.\(^103\) Northwestern National, the insurance company, brought a declaratory judgment action to determine its obligations, if any, to Khosa and Tigner.\(^104\)

Khosa's lease agreement with Tigner required that Khosa obtain property insurance naming Tigner as an additional insured.\(^105\) The policy, however, identified Tigner as a simple loss payee, with losses payable to the loss payee "as interests may appear."\(^106\) The policy excluded coverage to the insured for dishonest or criminal acts by the insured and for wear and tear from normal use.\(^107\) Northwestern asserted that it was not liable to Tigner under both exclusions, stating that Khosa's removal of property in order to avoid attachment was either dishonest or unlawful.\(^108\) Northwestern argued alternatively that damage resulting from such a move constituted routine wear and tear.\(^109\) Northwestern further claimed that it was not liable to Tigner under the loss payable clause because Tigner's rights were purely derivative of Khosa's rights.\(^110\)

The district court granted summary judgment against Khosa, who failed to appear at the trial court hearing.\(^111\) Having determined that

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\(^98\). *See id.* at 810.

\(^99\). *See id.* at 811.

\(^100\). 520 N.W.2d 771, 775 (Minn. Ct. App. 1994).

\(^101\). *See id.* at 772.

\(^102\). *See id.*

\(^103\). *See id.* at 772-73.

\(^104\). *See id.* at 773.

\(^105\). *See id.*

\(^106\). *See id.*

\(^107\). *See id.*

\(^108\). *See id.* at 773-74.

\(^109\). *See id.* at 774.

\(^110\). *See id.*

\(^111\). *See id.* at 773.
Khosa had no claim against Northwestern, the court then granted summary judgment against Tigner as well. On appeal, the court discussed the differences between simple loss payable provisions and standard mortgage clauses. The court determined that the policy did in fact include a simple loss payable clause and agreed that Khosa had made no claim against Northwestern. The court therefore ruled that “Tigner ha[d] no right to assert the claim.”

The Minnesota Court of Appeals has cited Allen as recently as 1997. In Bast v. Capitol Indemnity Corp., the insured and the insurer agreed to change the coverage terms of an existing policy from replacement cost to actual cash value. Neither party informed Bast, who held the contract for deed on the subject property and was named loss payee in the policy. When the property suffered significant hail and wind damage, the coverage was insufficient. Taking its lead from Allen and Young, the court employed a contract theory approach and found that the policy contained sufficient language to create an independent contract between the mortgagee and the insurer. On the basis of that contractual relationship, the court held that the insurer had a duty to inform the mortgagee of material changes to the policy.

E. The Current State of the Law in Minnesota

Two patterns emerge from this review of current Minnesota case law. First, in each of these cases, the courts have carefully applied a contract theory approach in determining the loss payee status of the mortgagee. This result should come as no surprise because the principles of simple and standard loss payee law are well established nationally. Further, the contract theory analysis approach is also the majority approach. The

112. See id.
113. See id. at 774.
114. See id. at 774-75.
115. Id. at 775.
117. See id. at 26.
118. See id.
119. See id.
120. See id. at 27-28. The court simply accepted the district court’s finding of a standard mortgage clause because surprisingly, Capitol Indemnity did not appeal that element of the decision. See id. at 27.
121. See id. at 28.
123. See supra notes 53-54.
124. See 1 INSURING REAL PROPERTY, supra note 6, § 1.04[2][a], at 1-20.
second pattern is more surprising, in light of the cases discussed from other jurisdictions.\textsuperscript{125}

In three of the four Minnesota cases cited, courts have ruled in favor of the mortgagee (and the fourth was distinguishable, involving a property owner rather than a mortgagee).\textsuperscript{126} However, because Minnesota courts follow the same contract theory analysis model used in other jurisdictions, one may infer that Minnesota courts would yield similar results when faced with similar fact situations. Given the precedential standing of \textit{Allen} and \textit{Young}, and the appellate court’s commentary in \textit{Khosa}, the law appears settled that a mortgagee of real or chattel property identified only as a loss payee would be viewed by the courts as a simple loss payee, subject to the same defenses as the insured.\textsuperscript{127} What is less certain is that such an outcome is either equitable or desirable.

When lenders, mortgagees and other secured parties require that mortgagees procure casualty insurance identifying the lenders, mortgagees and other secured parties as loss payees, they seek to protect their secured interests.\textsuperscript{128} They are no less concerned with protecting their interests from the acts or neglect of the mortgagor than from any other peril.\textsuperscript{129} This concern is the very reason for the advent of standard mortgage clauses.\textsuperscript{130} Yet more than 100 years later, mortgagees continue to find themselves unprotected by the very policies that they insisted their mortgagors procure.\textsuperscript{131}

Several undesirable results followed. First, mortgagees suffered significant losses, because they based their interest rate structures on a set of assumptions that included adequate indemnification.\textsuperscript{132} Even a cursory review of cases nationally indicates that the issue is litigated all too fre-

\textsuperscript{125.} See infra Part III.C.1.

\textsuperscript{126.} See infra Part III.C.2.

\textsuperscript{127.} See \textit{Allen}, 167 Minn. at 149, 208 N.W. at 817. The court stated that:

> When a policy contains a clause making the loss payable to the mortgagee as his interest may appear, sometimes called an open mortgage clause, the mortgagee is a sort of conditional appointee to receive what would otherwise come to the mortgagor, and if the mortgagor forfeit his right to insurance, the loss payable clause is of no avail to the mortgagee; but, under the union mortgage clause, the mortgagee has an independent contract with the insurer which is not affected by the future conduct of the insuring mortgagor.

\textit{Id.; see also Young}, 329 N.W.2d at 811 (indicating that Minnesota recognizes both the simple and standard mortgage clause forms).

\textsuperscript{128.} See 3 INSURING REAL PROPERTY, supra note 6, § 52.01.

\textsuperscript{129.} See Letter from Bruce Ulness, President, CornerStone State Bank, to author (Oct. 10, 1999) (on file with author).

\textsuperscript{130.} See id.; see also Steinmetz et. al., supra note 1, at 82.

\textsuperscript{131.} See supra note 54 for an extensive list of cases holding against mortgagees.

\textsuperscript{132.} See Letter from Bruce Ulness to author, supra note 129.
In addition to burdening the courts, this litigation costs all of the parties time and money. Finally, these decisions may result in an inefficient distribution of losses throughout the economic system. The efficacy of the contemporary insurance model is based on the remarkable accuracy and efficiency of the actuarial method insurers use to predict losses. As numbers of policies increase over time, the accuracy of actuarial models improves, enabling insurers to set premiums such that the entire group will absorb an individual loss.

Thus, insurance companies are in the best position to accurately predict risks and thereby distribute losses throughout the economic system most efficiently. A less attractive alternative would require lenders to purchase their own policies. The lenders then would recover the cost of premiums by charging increased interest rates. However, this again is economically inefficient because borrowers still would be required to purchase policies to protect their own interests in addition to paying higher loan interest rates.

It is difficult to ascertain why mortgagees so often continue to be identified as simple loss payees. In some instances, it may be simple inadvertence. Few courts have allowed equitable reformation of the policy where the mistake was shown to be mutual and the intent of the parties clear. Beyond mutual mistake, it is difficult to imagine a valid reason

133. See supra notes 53-54.
135. See generally Leah Wortham, The Economics of Insurance Classification: The Sound of One Invisible Hand Clapping, 47 OHIO ST. L.J. 835, 843 (1986) (discussing the expected utility theory). See also 1 INSURING REAL PROPERTY, supra note 6, § 1.03[1], at 1-12 (explaining the insurer's role in predicting and distributing loss).
139. See RICHARDS, supra note 6, at 467-71.
140. See id.
141. See Letter from Bruce Ulness to author, supra note 129.
142. See id.
143. See Esch v. Home Ins. Co., 43 N.W. 229, 231-32 (Iowa 1889); Norris v. Monarch Fire Ins. Co., 177 S.W.2d 831, 833-34 (Tenn. 1944). But see First Nat'l Bank v. Independent Fire Ins. Co., 934 F.2d 73, 75-76 (5th Cir. 1991) (applying Louisiana law; noting that it was unclear whether one of the parties ever had any intent to include plaintiff in the insurance policy); Farmers-Merchants Bank &
for insurers to issue simple loss payable policies on mortgaged properties. The policies clearly do not benefit either the mortgagee or the insured mortgagor, but the policies tend to favor the insurer because they eliminate the entire category of insured-caused risks. Given that uberrima fidei, the utmost good faith, still is required of all parties to an insurance contract, this result seems untenable. Whatever the reason, policies continue to be issued identifying secured mortgagees as simple loss payees. Upon finding ambiguities in the contract, some courts apply the principle of contra proferentum, interpreting the contract against the drafter, ordinarily the insurer, in order to rectify this inequity.

Equitable reformation and contra proferentum are limited responses at best. A better answer to the potential problem of under-indemnified mortgagees is available in Minnesota. A recent groundbreaking decision by the Minnesota Supreme Court abandoned the traditional contract theory analysis and took a fresh approach to determining the rights of parties to an insurance policy.

III. INNOCENT CO-INSUREDS

In Watson v. United Services Automobile Ass'n, the Minnesota Supreme Court joined Michigan, Georgia and Louisiana in taking a new approach to the problem of innocent co-insureds, a group similar in several ways to Trust Co. v. Employers Nat'l Ins. Corp., 553 So. 2d 1088, 1090-91 (La. Ct. App. 1989) (holding that the remedy did not lie where the party seeking reformation failed to show mutuality of intent to create a standard mortgage clause).

144. See Stein, supra note 10, at 739. Stein asks:

Why aren't these coverages automatically part of the basic policy? Why should a lender and its counsel (or insurance advisors) have to go through the trouble of remembering to check for these little added extras every time? In the view of the writer, this exercise merely creates a potential pitfall for lenders and malpractice insurance companies, with no corresponding benefit to anyone, even property and casualty insurance companies.

Id.

145. See 45 C.J.S. Insurance §§ 595, 638 (1993); 4 COUCH, supra note 7, § 65:24; 3 INSURING REAL PROPERTY, supra note 6, § 52.01; Steinmetz et. al., supra note 1, at 82.

146. See 1 OLDHAM, supra note 11, at 456; see also 12 HOLDSWORTH, supra note 5, at 540.

147. See supra notes 58, 54; see also supra text accompanying note 123.

148. See 1 INSURING REAL PROPERTY, supra note 6, § 1.04[2][a], at 1-20 to 1-21. The author also presents a general introductory analysis to ambiguity in insurance contract interpretation. See id.

149. See Watson v. United Serv. Auto. Ass'n, 566 N.W.2d 683, 689-90 (Minn. 1997) (adopting a statute-based theory analysis for insurance contracts in addition to the contract-based theory analysis).
innocent mortgagees. Like mortgagees, innocent co-insureds typically intend to be indemnified against all perils. Also like mortgagees, co-insureds have, at most, limited control over the actions of other named insureds. Finally, as courts eventually recognized, the relevant interest at stake for both co-insureds and mortgagees in post-loss litigation was not the interest in the property, but rather the interest in the proceeds of the policy.

The fundamental issue in Watson was whether an innocent spouse could be denied recovery when her estranged husband burned their house to the ground; the policy included an exclusion barring recovery if negligent or fraudulent acts of an insured caused the loss. This is a typical innocent co-insured scenario and the courts have wrestled with the competing interests for more than a century.

A. Historical Development

For years, courts routinely denied coverage to innocent co-insureds


151. See Reed v. Federal Ins. Co., 523 N.E.2d 480, 482 (N.Y. 1988). The Reed court reasoned that, “as a matter of fairness and equity . . . the independent wrongdoing of one insured should not bar recovery as to the coinsured under a policy that names and is intended to protect her.” Id. at 483 (emphasis added) (citations omitted).

152. See Cerven, supra note 8, at 855-56 (providing an example of the typical innocent co-insured scenario where the insured couple is estranged and in the midst of divorce proceedings). See, e.g., Watson, 566 N.W.2d at 685 (noting that the innocent co-insured was not living in the insured premises at the time her estranged husband set it on fire).

153. See Cerven, supra note 8, at 862. Because an insurance contract does not insure the property itself, the analogy drawn between the interests in the property and those under the contract is questionable. The proceeds of an insurance contract are personality and are held in the same way as “any personal property voluntarily acquired.” Id. (citing Hawthorne v. Hawthorne, 192 N.E.2d 20, 22 (N.Y. 1963) (other citations omitted)). Although the value of the insurance proceeds and that of the property are similar, the proceeds of the insurance are not a substitute for the property. See id.

154. See Watson, 566 N.W.2d at 685.


under a mixture of property, marital relationship and public policy theories. Some courts found that, because the marital property was held in joint ownership, the insurable interest was joint as well. This theory was at times bolstered by the fact that the policy was issued in both spouses' names. In Rockingham Mutual Insurance Co. v. Hummel, the court noted that the policy limitations applied to the “Named Insured” and that the named insured in this case was the marital entity. Thus, “[i]f either spouse violated any one of [the contractual] duties, the breach was chargeable to the “Named Insured” preventing either spouse from recovering any amount under the policy.”

Other courts found significance in the marital relationship itself, stating that the interests of husband and wife were “inextricably intertwined” and therefore, shared contract interests also should be considered “inseparable.” As joint tenants with joint and inseparable interests, mar-

157. See Marvin L. Karp, Arson and the Innocent Co-insured, 22 SPG-BRIEF 8, 9-12 (1993); Shoening, supra note 156, at 895.
158. See, e.g., Short v. Oklahoma Farmers Ins., 619 P.2d 588, 590 (Okla. 1980) (holding that joint title and tenancy requires voiding of entire policy in case of “fraud or false swearing” by the insured). The court in Short reasoned that three bases existed for denying coverage to the innocent spouse. See id. First, each spouse had a joint obligation under the contract to protect and preserve the property. See id. In its discussion of the neglect provision, the court tacitly asserted that one spouse burning the house at least implied that the other failed in this contractual duty. See id. Second, when the property was jointly owned, an innocent insured could not recover on a policy where a joint co-owner willfully set fire to the property. See id. The court stated:

Where, as here, the title to the property is held jointly and that property insured under a single policy and is destroyed by a joint insured's act of arson, the entire policy is voided under the first quoted contract provision declaring the policy to be void in the case of fraud or false swearing on the part of the insured.

Id. Third, the court noted the great risk arson presents to the general public and stated that it would be contrary to public policy to permit a member of the “entity” which perpetrated the arson to collect the proceeds of the policy. See id.
160. See id.
161. Id. (citations omitted).
162. See Vance v. Pekin Ins. Co., 457 N.W.2d 589, 591 (Iowa 1990) (citing Cerven, supra note 8, at 858-62); see also Jones v. Fidelity & Guaranty Ins. Corp., 250 S.W.2d 281, 283 (Tex. Civ. App. 1952) (holding that the plaintiff co-insured could not benefit under the policy, even though she was divorced from the arsonist spouse at the time of the fire), overruled by Kulubis v. Texas Farm Bureau Underwriters Ins. Co., 706 S.W.2d 953 (Tex. 1986). The Jones court reasoned that, because the couple was married at the time the policy was issued, the ensuing contract was between the entity of husband and wife and therefore binding on both. See id. The Texas Supreme Court has since overruled the Jones holding. See Kulubis v. Texas Farm Bureau Underwriters Ins. Co., 706 S.W.2d 953, 954-55 (Tex.
ried couples also were thought to share a joint duty to "save and preserve the insured property." Further, some courts feared complicity between the spouses, finding it difficult to believe that one spouse could plan and commit arson completely without the other's knowledge.

Finally, some courts expressed concern that the wrongdoer might profit from his or her wrong, either directly or vicariously through his or her spouse, contrary to public policy. Again, this notion was intermixed with the other aforementioned theories. In *Short v. Oklahoma Farmers Union Insurance Co.*, the Oklahoma Supreme Court stated, "To allow recovery on an insurance contract where the arsonist has been proven to be a joint insured would allow funds to be acquired by the entity of which the arsonist is a member and is flatly against public policy." 166

Over time, a recurrent pattern emerged. Frequently, as in *Watson*, the couple is estranged and in the midst of divorce proceedings at the time of the arson. Uncomfortable with what seemed to be harsh and inequitable outcomes, courts shifted their analyses away from these theories. In reconsidering the earlier theories, the courts came to doubt the legitimacy of the analogy between property interests and interests in the insurance policy. 167

In *Vance v. Pekin Insurance Co.*, the Iowa Supreme Court recognized that "[p]roving divisibility of property interest may be difficult, if not im-

163. See *Jones*, 250 S.W.2d at 282.

164. See *Cerven*, *supra* note 8, at 851.

165. See *Short v. Oklahoma Farmers Ins.*, 619 P.2d 588, 590 (Okla. 1980). But see *Cerven*, *supra* note 8, at 863 (suggesting that courts could easily prevent wrongdoers from benefitting from the wrong by awarding the proceeds of the policy to the innocent co-insured via a constructive trust).

166. *Short*, 619 P.2d at 590.

167. See *Cerven*, *supra* note 8, at 855-56.

168. See *Lindahl*, *supra* note 155, at 435. See, e.g., *Steigler v. Insurance Co. of N. Am.*, 384 A.2d 398, 402 (Del. 1978) (where the husband attempted to murder his co-insured wife); *St. Paul Fire and Marine Ins. Co. v. Molloy*, 433 A.2d 1135, 1135-36 (Md. 1981) (where the couple had experienced some marital problems and had lived apart for several months in the year before the fire); *Morgan v. Cincinnati Ins. Co.*, 307 N.W.2d 53, 53 (Mich. 1981) (where husband and wife were living apart at the time of the fire); *Howell v. Ohio Cas. Ins. Co.*, 327 A.2d 240, 241 (N.J. Super. Ct. App. Div. 1974) (where the husband took his own life in the fire); *Delph v. Potomac Ins. Co.*, 620 P.2d 1282, 1283 (N.M. 1980) (where the wife had moved out and was suing for divorce at the time of the fire); *Kulubis v. Texas Farm Bureau Underwriters Ins. Co.*, 706 S.W.2d 953, 954 (Tex. 1986) (where the couple was in the midst of divorce proceedings and were not living together at the time of the fire); *Felder v. North River Ins. Co.*, 435 N.W.2d 203, 204 (Wis. Ct. App. 1988) (where the husband set the fire and then took his own life).

169. See *Cerven*, *supra* note 8, at 857-75; *Karp*, *supra* note 157, at 10-11.

170. See *Vance v. Pekin Ins. Co.*, 457 N.W.2d 589, 591 (Iowa 1990) ("While the value of the insurance proceeds and that of the property are similar, the proceeds of the policy are not a substitute for the property.") (citation omitted).
possible. This property rationale ignores the nature and extent of parties' rights and duties as expressed by the insurance policy. Further, the contractual duties under the policies came to be viewed as several and separate, rather than joint. Other courts concluded that the wrongful acts of one spouse could not reasonably be imputed to the other, absent proof of complicity. Finally, courts conceded that barring recovery to innocent co-insureds was "an inappropriate method of deterring crime and preventing a wrongdoer from profiting from his or her own wrong."

B. The Contract Analysis Approach

In Hoyt v. New Hampshire Fire Insurance Co., the New Hampshire Supreme Court moved away from these traditional approaches, rejecting the notion that a policy issued to co-tenants created a joint obligation under the contract. Rather than looking at the relationship of the parties to each other, the court found it more reasonable to focus on the construction of the language in the policy. The court stated:

Whether the rights of the obligees are joint or several is a question of construction, and in construing an insurance contract the test is not what the insurance company intended the words of the policy to mean but what a reasonable person in the position of the insured would have understood them to mean.

171. Id. at 592 (quoting Cerven, supra note 8, at 865).
173. See Hosey v. Siebels Bruce Group, S.C. Ins. Co., 363 So. 2d 751, 753 (Ala. 1978) (holding that the insurance company may not deny coverage to an innocent co-insured absent a finding that the innocent co-insured had set the fire, had knowledge and authorized the setting or later ratified the arson); American Econ. Ins. Co. v. Liggett, 426 N.E.2d 136, 140 (Ind. Ct. App. 1981) (holding that our notions of civilization are based on individual responsibility and accountability and that it would be wrong to impose vicarious liability merely on the basis of the marital relationship). For the proposition that imputing the act of the arsonist-insured to the innocent co-insured may violate the co-insured's rights to due process and equal protection under the constitution, see Brief of Amicus Curiae, Michigan Trial Lawyers Ass'n, Borman v. State Farm Fire & Cas. Co., 521 N.W.2d 266, 266 (Mich. 1994); see also Steigler, 384 A.2d 398, 401 (Del. 1978).
176. Id. at 128
While this case dealt with unmarried joint tenants, the move away from a presumption of joint obligation and toward contract interpretation opened the way to broad changes in rulings for all types of innocent co-insureds. It remained incumbent on the innocent co-insured, however, to prove that his or her interest in the property was severable. Thus this new theory, while looking in part to the language of the contract, did not entirely abandon analysis under the joint property theory. One commentator has suggested that “[p]erhaps the opportunity to rebut the joint contract presumption is a compromise between the desire to avoid a benefit to the wrongdoer and the indemnification objectives of the insurance contract.”

A new approach, known as the “best reasoned rule,” corrected the deficiencies of both the older approaches and the rebuttable presumption theory. Disregarding entirely the question of whether the co-insureds’ interests in the property are joint, the New Jersey Supreme Court ruled in Howell v. Ohio Casualty Insurance Co., that a spouse’s fraud would not defeat the claim of the innocent co-insured. The court determined that liability for fraud was itself several and separate, irrespective of the joint nature of the property or contract interests. The Howell court also noted that, while not the controlling factor, ambiguities in the policy language supported the decision. Possible ambiguity later proved to be an important element in the evolution of innocent co-insured law. A number of courts since have followed the best-reasoned rule and allowed recovery by innocent co-insureds irrespective of the joint nature of the contract or property interests.

This conclusion is supported by the policy provisions prepared by defendant carrier, even though we do not deem them necessarily controlling here. The “Named Insured” is the husband “and/or” plaintiff wife. Although the term “Insured” means the named insured, the use of the ambiguous phrase “and/or” and the reasonable expectations of the insureds by reason thereof compel a determination that the fraudulent conduct by one insured should not void the policy as to the other who is completely innocent thereof.

177. See Cerven, supra note 8, at 864.
178. See id. at 864-65.
179. See id. at 865.
180. Id.
181. See id. at 865-66.
183. See id. at 242.
184. See id. The court stated:

This conclusion is supported by the policy provisions prepared by defendant carrier, even though we do not deem them necessarily controlling here. The “Named Insured” is the husband “and/or” plaintiff wife. Although the term “Insured” means the named insured, the use of the ambiguous phrase “and/or” and the reasonable expectations of the insureds by reason thereof compel a determination that the fraudulent conduct by one insured should not void the policy as to the other who is completely innocent thereof.

185. See Schoenig, supra note 156, at 899-900.
186. See Lindahl, supra note 155, at 441. A more common alternative used to
The *Howell* court noted that "[t]he unity of person of husband and wife [expressed through tenancy by the entirety] gives no clue to the relationship that ought properly to obtain between the owners of the proceeds of insurance."\(^{187}\) In cases subsequent to *Howell*, however, it is not clear whether courts focused entirely on the severable nature of the liability for fraud or if they considered severability of the contract interests, as in *Hoyt*.\(^{188}\) Regardless, these decisions have essentially eliminated consideration of property interests and the marital relationship as factors in innocent co-insured cases.\(^{189}\)

At the same time, courts have reconsidered their position on public policy.\(^{190}\) Once property interests and antiquated concepts of the mar-

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\(^{187}\) Cerven, *supra* note 8, at 867 n.113 (quoting *Howell*, 327 A.2d at 144). The court stated:

Both *Howell* and its progeny are unclear as to whether they focus on the severability of the contract rights or the liability for fraud to determine the innocent spouse's rights. If the courts were to focus solely on the fact that the liability for fraud is separate, recovery would be permitted regardless of the nature of the contract interests. . . . If contract interests were the sole basis of recovery, then even if fraud was involved, the innocent co-insured would not be entitled to recover where the contract interests were not found to be joint. At any rate, the courts employ both factors in holding that the innocent spouse is entitled to recover, thereby reaching the most equitable result under the circumstances.

Id.


\(^{189}\) See Cerven, *supra* note 8, at 867.

\(^{190}\) See *Hildebrand*, 386 A.2d at 331-32 (holding that the payment of policy benefits of "insurance to indemnify an insured against the consequences of a violation of law by others without his or her direction or participation" did not violate public policy) (citing Pawtucket Mut. Ins. Company v. Labrecht, 190 A.2d 420, 423 (N.H. 1963)); Reed v. Federal Ins. Co., 523 N.E.2d 480, 483 (N.Y. 1988) ("[A]s a
riage relationship were removed from the determination, the public policy issue could be viewed in an entirely new light. In Wisconsin, the supreme court reasoned that married couples consist of two individuals each of whom must be held responsible only for his or her own acts.\(^{191}\) Likewise, it was held contrary to public policy and "our basic notions of fair play and justice" to impose liability for fraud on an innocent person. Later decisions note that the wrongdoer likely will not benefit from the wrong in cases where the possibility does exist, and that the court has the means available to mitigate that possibility.\(^{192}\)

Insurers then were left to deny benefits only when complicity could be ascribed to both insureds—not an easy task.\(^{193}\) It is exceedingly difficult to prove arson and it is more difficult still to prove conspiracy to

\[\text{matter of fairness and equity} \ldots\] the independent wrongdoing of one insured should not bar recovery as to the co-insured under a policy that names and is intended to protect her.\(^{194}\) Hedtcke v. Sentry Ins. Co., 326 N.W.2d 727, 740 (Wis. 1982) (reasoning that an absolute bar to recovery by innocent co-insureds was "an inappropriate method of deterring crime and preventing a wrongdoer from profiting from his or her own wrong").

\(^{191}\) See Hedtcke, 326 N.W.2d at 740. The court noted that "imputing the incendiary actions of an insured to the innocent insured and creating an absolute bar to recovery by the innocent insured, produces inequitable results." \(^{Id.}\)

\(^{192}\) See id.


Mere family relationship to the arsonist, which does not bestow a property right or other direct financial benefit in the proceeds of insurance, does not bar a recovery. Here the only benefit to the arsonist is an indirect one whereby his spouse and children recover what the spouse and children had already owned and insured. The wrongdoer has no gain, advantage or recovery of what he owned prior to the fire.

\(^{Id.}\)

\(^{194}\) See Schoenig, supra note 156, at 901.

While the \ldots theory "mitigates the harshness and inequities of the other \ldots theories," it has been criticized as being "too overprotective of the marital relationship." Further, it may invite collusion between the husband and wife and "create the virtually insurmountable obstacle of proving both the arson of one spouse, and the conspiracy between spouses in order to defeat recovery in the first instance." Even if complicity is suspected, however, "the alleged innocence of the innocent spouse will probably go unchallenged unless there is direct proof of collusion." The difficulty of proving spousal complicity and the threat of litigation for bad-faith refusal to pay a claim encourage the insurer to settle the claim with the insured.
Insurers, however, by carefully phrasing the exclusionary language of contracts, successfully denied claims of co-insureds. These policies included language that voided the entire policy whenever fraudulent or negligent actions of "an" or "any" insured were present. Many courts found such language clear and unambiguous and have barred recovery of the proceeds of insurance. Essentially, the issue of divisible interests versus divisible liability was reduced to a question of contract construction. Policies stating that the fraudulent or negligent acts of "the" insured were deemed ambiguous (recall the court's comment in Howell that the policy language was ambiguous), while policies referring to the acts of "an" or "any" were deemed not ambiguous.

When faced with the ambiguous use of "the" insured in the exclusionary language, courts began applying the rule from Hoyt, reading the contract terms to mean "what a reasonable person in the position of the insured would have understood them to mean." Courts determined that an ordinary person would believe that the exclusion denied coverage only to "the" insured that committed the fraud. Thus, the exclusion was

195. See Cerven, supra note 8, at 870.
197. See Karp, supra note 157, at 12; Schoenig, supra note 156, at 900.
201. See Kulubis v. Texas Farm Bureau Underwriters Ins. Co., 706 S.W.2d 953, 955 (Tex. 1986). The court held that:

This test will best protect the insurance company from fraud while assuring that the insurance company will not be unjustly enriched. It will also permit an innocent victim whose property has been destroyed to collect under any insurance policy for a loss reasonably expected to be covered. This test also avoids the imputation of criminal action to an innocent victim.

Id.; see also Lindahl, supra note 155, at 442. Lindahl points out that courts have been split as to whether "the" insured is ambiguous or not. See id. Some courts have held that the term "the" unambiguously refers only to the insured that actually commits the fraud, thus allowing policy awards to the innocent co-insured. See id. According to Lindahl, other courts have arrived at the same result, by holding the word "the" insured to be ambiguous. See id. Since courts will interpret ambiguous terms in the manner most favorable to the insured, innocent co-insureds have prevailed where the court held "the" insured to be ambiguous. See id.
limited to “the” insured guilty of fraud or negligence. However, where the exclusion read “an” or “any,” courts found no ambiguity and held the policy to be valid on its face. This dual approach reflects the current treatment of innocent co-insured law in much of the United States. However, recent decisions in Michigan, Louisiana, Georgia and Minnesota have taken innocent co-insured law in a new direction.

C. The Statutory Analysis Approach

1. Other Jurisdictions

Between 1943 and 1951, virtually every state in the U.S. adopted a statutory fire insurance policy. In *Morgan v. Cincinnati Insurance Co.*, the Michigan Supreme Court looked to the state’s statutory fire policy for guidance in holding for an innocent co-insured whose estranged husband set fire to their home during the pendency of their divorce. The court ruled that the theory asserted by the insurance company required the unlikely assumption that the legislature intended to impose a duty of suretyship upon each of the insureds. The statutory policy read:

This entire policy shall be void if, whether before or after a loss, the insured has willfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating thereto.

The defendant insurance company argued that the innocent wife’s claim was barred because she and her husband owned inseparable interests in the subject property. The insurer asserted that, given their tenancy by entireties, the fraud of the husband must be imputed to the

202. See *Hoy*, 29 A.2d at 123 ("Whether the rights of obligees are joint or several is a question of construction . . .").
203. See *Vance*, 457 N.W.2d at 593; *McAllister*, 640 A.2d at 1289. But see *Osbon*, 632 So. 2d at 1160-61 (finding “an” in the contract unambiguous, but holding the contract unenforceable as contrary to state statute).
204. See *Shoenig*, supra note 156, at 899.
206. See *COMMITTEE ON PROPERTY INS. LAW TORT AND INS. PRACTICE SECTION, supra* note 9, at 3.
208. See id.
210. See *Morgan*, 307 N.W.2d at 53.
Rejecting the defendant’s theory, the court remanded the case to the lower court for reformation of the policy and for award of the policy benefits to the innocent spouse.\footnote{212}

In its decision, the court limited its former stance on one important issue, and reversed its position on another. Prior to \textit{Morgan}, the Michigan Supreme Court had barred recovery by co-insureds, noting that “[a] breach caused by intentional destruction is chargeable to both insureds and precludes recovery by the innocent joint insured.”\footnote{213} The court further stated that “[w]e no longer consider the application of the theory of implied suretyship appropriate in insurance law.”\footnote{214} Michigan courts had embraced the theory of imputed suretyship since 1884.\footnote{215} Explaining the change, the court commented:

To adopt the reading [of the statutory fire policy] of the insurer would require ascribing to the Legislature an intent to impose a mutual obligation of suretyship on each of several persons insured: that each insured must not only undertake to forbear from fraud himself, but must also undertake to prevent each of the other persons insured from engaging in fraud on pain of losing all interests under the policy. Such intent is unlikely; as this case aptly illustrates, an insured often has no control over the conduct of others.\footnote{216}

In 1990, the U.S. District Court in Michigan followed a similar analysis and interpreted the policy language as failing to meet the minimum protection required by statute.\footnote{217} At issue in \textit{Ponder v. Allstate Insurance Co.} was a policy exclusion that read in part, “policy is void if any insured person intentionally conceals or misrepresents any material fact or circumstances, before or after a loss.”\footnote{218} As previously noted, the use of “any” insured in the exclusionary text had been held unambiguous in several earlier rulings.\footnote{219} Here, the court chose not to concern itself with the

\footnotetext{211}{See id.}
\footnotetext{212}{See id. at 55.}
\footnotetext{213}{Id. at 54 (citing Klemens v. Badger Mut. Ins. Co., 99 N.W.2d 865, 866 (Wis. 1959)).}
\footnotetext{214}{Id.}
\footnotetext{215}{See Monaghan v. Agricultural Fire Ins. Co., 18 N.W. 797, 804 (Mich. 1884) ("The attempt to defraud the company by any one of the insured, by the making of false affidavits in relation to loss, is a complete bar to a recovery upon the policy.").}
\footnotetext{216}{\textit{Morgan}, 307 N.W.2d at 55.}
\footnotetext{218}{Id. at 61.}
\footnotetext{219}{See, e.g., Spezialetti v. Pacific Employers Ins. Co., 759 F.2d 1139, 1142 (3d Cir. 1985) (holding that a homeowner's policy barred recovery to the innocent spouse where the policy exclusion included the phrase “any insured.”)}
question of ambiguity. The statutory policy used the word "the," which the Morgan court already held indicated severable interests. 220 Applying Michigan law, specifically Morgan, the district court ruled that the effect of the use of "any" insured was to place the plaintiff co-insured beneath the minimum required coverage under the statute. 221 The court again reformed the contract and awarded the policy benefit to the innocent co-insured. 222

The Supreme Court of Michigan adopted the Ponder court's statutory interpretation of the statute in Borman v. State Farm Fire & Casualty Co. 223 In this 1994 decision, the Borman court stated:

We hold that the provisions of the insurance policy issued by defendant State Farm Fire & Casualty Co., insofar as they deny coverage to an insured who is innocent of wrongdoing by another insured, are inconsistent with the provisions of the standard policy, and, thus, contrary to the provisions of the standard policy, and are therefore void insofar as fire insurance coverage is involved. 224

In Georgia, the law evolved in similar fashion. In Richards v. Hanover Insurance Co. the state supreme court applied the ambiguity rule to a policy exclusion for acts of "the" insured and held in favor of the innocent co-insured plaintiff. 225 Five years later, the Eleventh Circuit Court of Appeals, applying Georgia law, found in favor of an insurer where the contract asserted that the policy was void if "an" insured has: 1) intentionally concealed or misrepresented any material fact or circumstance; 2) engaged in fraudulent conduct; or 3) made any false statements relating to the insurance. 226 The court based its ruling on the clear and unambiguous nature of the contract. 227

Finally, in 1994, the Georgia Court of Appeals followed Michigan's statutory approach in a matter of first impression and held that a policy denying coverage to an innocent co-insured fell below the minimum stan-

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221. See Ponder, 729 F. Supp. at 62.
222. See id.
224. Id.
227. See id. at 1386.
standard established by statute. In *Fireman's Fund Insurance Co. v. Dean*, the court considered whether an insured's concealment of material facts should bar recovery by a co-insured. The court noted that the statutory policy:

[R]equries fire insurance policies covering Georgia property contain language at least as favorable to the insured as the applicable portions of the standard fire policy... [and that] [t]he applicable portion of the Standard Fire Policy provides that [t]his entire policy shall be void if, whether before or after a loss, the insured has willfully concealed or misrepresented any material fact or circumstance concerning this insurance or the subject thereof, or the interest of the insured therein, or in case of any fraud or false swearing by the insured relating thereto.

Interestingly, the Georgia statute itself had been found ambiguous in *Richards*, but the policy at issue in *Dean* was found to be unambiguous. Thus, the question for the *Dean* court was whether an unambiguous contract was required by law to be reformed in conformance with an admittedly ambiguous form. The court held that, ambiguous or not, the standard policy established a minimum level of coverage beneath which an insurance policy could not fall. Finding that the policy at issue fell beneath that level, the court held for the plaintiff co-insured.

2. Minnesota

The evolutionary process in Minnesota began in 1987 in *Hogs Unlimited v. Farm Bureau Mutual Insurance Co.* Here, the co-insureds were business partners rather than husband and wife. When one of the partners intentionally killed off the livestock belonging to the partnership, the insurer refused to pay policy proceeds to the innocent partners. The language of the policy matched verbatim the Minnesota standard fraud

229. See id. at 437.
230. Id. at 438.
231. See id. at 437 (citing *Richards v. Hanover Ins. Co.*, 299 S.E.2d 561, 563-64 (Ga. 1983)).
232. See *Dean*, 441 S.E.2d at 437-38.
233. See id. at 438.
234. See id.
236. See id. at 382.
237. See id. at 383.
provision, including the phrase "the insured." Noting that many courts found the phrase "the insured" to be ambiguous, the court relied on legislative intent to determine the phrase's meaning. The court stated:

We agree with Plaintiff's position... We do not think the legislature intended to visit the blame of the errant insured on co-insureds who, having no control over the unauthorized conduct, are themselves blameless; nor do we think the legislature intended to make insureds their brother's keeper under penalty of losing their own insurance protection.

The court held that "the insured" in the statutory policy refers to the insured guilty of the fraud and therefore can only refer to the same type of insured in an insurance policy. Ultimately, the court awarded policy benefits to the innocent partners.

In 1993, the issue of innocent co-insureds again was addressed in Reitzner v. State Farm Fire & Casualty Co. The Minnesota Court of Appeals considered language that purported to void the policy to any and all insureds where one insured "causes or procures a loss to property covered under th[e] policy for the purpose of obtaining insurance benefits." The court noted that the trend toward allowing innocent insureds to recover insurance benefits "where a loss is caused by the wrongful acts of other insureds" is permitted when an insurance policy does not "forbid coverage for innocent insureds." The court affirmed the lower court's finding that the policy was clear and unambiguous and held for the insurer.

238. See id. at 384.
239. See id. at 384-85.
240. Id. at 384.
241. See id. at 384-85.
242. See id. at 386.
243. 510 N.W.2d 20 (Minn. Ct. App. 1993). The Reitzner court discussed whether an innocent insured is entitled to insurance proceeds when one insured "intentionally causes loss to the property." See id. at 22-24.
244. Id. at 22.
245. Id. at 24 (citations omitted).
246. See id. Interestingly, Reitzner argued that the language of the Standard Statutory Fire Policy should control. See id. As an assignee of a contract for deed of the subject property, Reitzner alleged that as a contract for deed vendor he should be treated as a mortgagee. See id. If Reitzner were treated as a mortgagee, then Minnesota Statute section 65A.01, subdivision 3 (the Minnesota Standard Statutory Fire Insurance Policy) would allow him to recover for the intentional acts of the insured. See id. While seemingly accepting the gravamen of Reitzner's argument, the court noted that the statute spoke only of mortgagees and not contract for deed vendors. See id. at 24-25.
Finally in 1997, the Minnesota Supreme Court followed Michigan precedent in *Watson v. United Services Automobile Ass'n*. The facts in *Watson* follow the typical pattern. Mr. and Mrs. Watson were in the process of purchasing a mobile home on a contract for deed. After some years of marriage, the couple separated and Mrs. Watson left the home. Two weeks prior to the fire in the Watsons’ home, Mrs. Watson sought and received dissolution of the marriage, but the decree was not filed until several days after the fire.

After the Watsons filed a loss report, the insurer, United Services Automobile Association (USAA) advanced the Watsons $10,000 pursuant to their insurance policy. Later, when USAA’s investigation determined that the fire had been set intentionally, it denied further proceeds under the policy. Mrs. Watson sued for the remainder of the policy benefits, while USAA counterclaimed for return of the $10,000 advance. At trial, the jury, by special verdict, found that Mr. Watson intentionally set the fire.

The trial court concluded that the arson voided the Watsons’ insurance coverage and awarded USAA costs and disbursements from Mr. Watson but not from Mrs. Watson. It based its finding on the language of the policy, which excluded coverage for “any loss arising out of any act committed: 1) by or at the direction of an insured; and 2) with the intent to cause a loss.” The policy exclusion continued “[t]he entire policy will be void if ‘an’ insured has . . . after a loss, willfully and with intent to defraud, concealed or misrepresented any material fact or circumstance relating to this insurance.” The court stated that it was “compelled to follow Minnesota precedent,” but noted its regret at its finding and urged reversal on appeal. The trial court further stated that allowing USAA to

247. 566 N.W.2d 683, 689 (Minn. 1997).
248. See Cerven, supra note 8, at 855-56; Lindahl, supra note 155, at 435-37.
249. See *Watson*, 566 N.W.2d at 685.
250. See id.
251. See id.
252. See id.
253. See id. (stating that the second investigation was prompted by Mrs. Watson’s subsequent claim for further proceeds under the Watsons’ insurance policy).
254. See id.
255. See id.
256. See id.
257. Id. at 685-86.
258. Id. at 686.
259. Id. (quoting Reitzner v. State Farm Fire & Cas. Co., 510 N.W.2d 20, 24 (Minn. Ct. App. 1993)).
260. See *Watson*, 566 N.W.2d at 686 (“[T]he district court stated that it had entered judgment in favor of USAA ‘reluctantly’ and urged reversal on appeal.”).
escape coverage for Mrs. Watson would amount to "a gross miscarriage of justice." 261

On appeal, the Minnesota Court of Appeals agreed with the trial court's finding that the terms of the policy were unambiguous. 262 Nonetheless, the appellate court reversed the judgment. 263 The appellate court reasoned that the Minnesota Standard Fire Policy compelled ruling for Mrs. Watson. 264 The court noted that in Hogs Unlimited, the Minnesota Supreme Court concluded that use of "the insured" in an exclusionary provision referred only to the insured that had actually committed the fraud.

The court also discussed Krueger v. State Farm Fire & Casualty Co., which held that insurers might not provide less coverage than is required by the statute. 265 Ultimately, the Minnesota Court of Appeals concluded that, in light of the statutory policy language, USAA could not deny coverage to Mrs. Watson. 266

On final appeal, the Minnesota Supreme Court analyzed the matter in a two-step process. First, the court examined whether the policy language was ambiguous, and second, it determined whether the policy complied with Minnesota Statutes section 65A.01. 267 In the first part of

261. Id. at 686-87.
263. See id. at 504.
265. See id. at 502 (citing Hogs Unlimited v. Farm Bureau Mut. Ins. Co., 401 N.W.2d 381, 384-85 (Minn. 1987)).
266. See id. at 503 (citing Krueger v. State Farm Fire & Cas. Co., 510 N.W.2d 204, 209 (Minn. Ct. App. 1993)).
267. See id. at 503. The court acknowledged that the Hogs Unlimited court had not addressed the issue currently before the court. See id. at 502. In addition to holding that the Minnesota Standard Fire Policy limited fraud provisions to denial only of the claims of the insured who committed the fraud, the Hogs Unlimited court also stated that an innocent insured may recover "unless forbidden by the insurance contract." Id. at 502-03 (citation omitted). The Watson II court admitted that "[t]his appears to indicate that an insurer could by the terms of the policy deny coverage for an innocent insured." Id. at 503. However, finding this language in direct conflict with the Minnesota Supreme Court's ruling in Krueger, which held that insurers cannot provide less coverage than required by the statutory policy, the court resolved the conflict in favor of the insured. See id. The court explained its decision by reasoning that in Hogs Unlimited, the Minnesota Supreme Court reviewed the legislature's intent in creating the standard policy and determined that "public policy favors allowing coverage." Id.; see also Hogs Unlimited, 401 N.W.2d at 384. The court also noted that "an innocent insured has a reasonable expectation of coverage," thereby deciding in favor of Mrs. Watson. See Watson II, 551 N.W.2d at 503.
the analysis, the court noted that the national trend had been to apply the "contract-based theory." The court recalled that it followed this approach in *Hogs Unlimited* when it held that the term "the insured" was ambiguous, and that by that same analysis the appellate court held in *Reitzner* that "any insured" and "an insured" were not ambiguous terms.

Following the contract-based theory, the Minnesota Supreme Court concluded that USAA's policy "unambiguously bars coverage for innocent co-insured spouses."

This conclusion did not end the court's inquiry. The court used the "statute-based theory" in deciding the second part of the analysis, which requires that "[i]f the exclusion of coverage contained in the insurance policy conflicts with the level of protection provided in the statutory standard fire insurance policy, the court will hold the insurance policy unenforceable." The court acknowledged that *Hogs Unlimited* left open the possibility that insurers intentionally could exclude innocent co-insureds when the court stated that innocent partners might recover "unless forbidden by the insurance contract." The court reasoned that neither that court, in *Hogs Unlimited*, nor the appellate court in *Reitzner*, was presented with the "conflict between an insurance policy and the Minnesota Standard Fire Insurance Policy."

Analyzing the legislative intent of the Minnesota Standard Fire Insurance Policy, the court quoted *Heim v. American Alliance Insurance Co.*, noting that the purpose of the statute was to "do away with the evils arising from the insertion in policies of conditions ingeniously worded which restricted the liability of the insurer and gave the insured less protection than he might naturally suppose he was getting under the contract."

The court went on to cite the statute's conformity clause, which read:

No policy or contract of fire insurance shall be made, issued or delivered by any insurer . . . on any property in this state, unless it shall provide the specified coverage and conform as to all

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269. See id. at 688 (noting that this approach "focuses on a contractual analysis of . . . insurance policy provisions").

270. See id. at 689 (citing *Hogs Unlimited*, 401 N.W.2d at 385-86; *Reitzner v. State Farm Fire & Cas. Co.*, 510 N.W.2d 20, 24 (Minn. Ct. App. 1993)).

271. *Id.*


273. See *Watson*, 566 N.W.2d at 690 (citing *Hogs Unlimited*, 401 N.W.2d at 386).

274. *Id.* (discussing *Hogs Unlimited*, 401 N.W.2d at 386; *Reitzner*, 510 N.W.2d at 24).

275. *Id.* (quoting *Heim v. American Alliance Ins. Co.*, 147 Minn. 283, 287, 180 N.W. 225, 226 (1920)).
provisions, stipulations, and conditions, with such form of policy, except as provided in ... statutes containing specific requirements that are inconsistent with the form of this policy.  

The court then noted that *Krueger* allowed insurers to substitute additional or different terms in their policies, but only so long as they offered the same or greater coverage than the statutory policy.  

The USAA policy contained an “intentional loss” exclusion, yet there is no parallel provision in the statutory policy. The court determined that USAA’s “intentional loss” provision, insofar as it excluded coverage for innocent co-insured spouses, was at odds with the rights and benefits of the Minnesota Standard Fire Insurance Policy. The court affirmed the appellate court’s ruling, holding that the term “the insured” in the statutory policy indicated the legislature’s intent that innocent co-insureds receive policy benefits in spite of the wrongful acts of others. Thus, it is settled law in Minnesota that, by operation of statute, innocent co-insureds cannot be denied policy benefits on the basis of contractual exclusions.

IV. ARGUMENT FOR SIMILAR TREATMENT OF MORTGAGORS

Minnesota historically has applied a contract analysis approach to determine whether loss payable clauses are standard or simple. This application once was the case with innocent co-insureds as well. However, by closely reading the Minnesota Standard Fire Insurance Policy and

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276. *Id.* (quoting MINN. STAT. § 65A.01, subd. 1 (1998)).

277. *See id.* (citing *Krueger* v. State Farm Fire & Cas. Co., 510 N.W.2d 204, 209 (Minn. Ct. App. 1993)). The *Watson* court also noted that the standard statutory policy permitted such variations of form so long as the policy “afford[ed] the insured all the rights and benefits of the Minnesota standard fire insurance policy.” *Id.* (citing MINN. STAT. § 65A.01, subd. 1 (1998)). Minnesota statute section 65A.01, subdivision 1 speaks specifically to the mortgagee clauses defined in subdivision 3, stating that, “the provision in relation to mortgagee interests and obligations in said Minnesota standard fire insurance policy shall be incorporated therein without change . . . .” MINN. STAT. § 65A.01, subd. 1 (1998).

278. *See Watson*, 566 N.W.2d at 691.

279. *See id.*

280. *See id.* at 691-92.


Minnesota Statute section 65A.01, the Minnesota Supreme Court moved beyond the contract analysis method. The Watson Court recognized that denying coverage to innocent co-insureds because of fraudulent or negligent acts of a co-insured would place the innocent co-insured beneath the minimum coverage required by the statute. In adopting the statutory approach, the court departed from the contract analysis approach to innocent co-insureds. This same reasoning should be applied by analogy to innocent mortgagees. As with innocent co-insureds, the language in the Minnesota Standard Fire Policy should control. The statute states:

Notwithstanding any other provision of this policy, if this policy shall be made payable to a mortgagee or contract for deed vendor of the covered real estate, no act or default of any person other than such mortgagee or vendor or the mortgagee’s or vendor’s agent or those claiming under the mortgagee or vendor, whether the same occurs before or during the term of the policy, shall render this policy void as to such mortgagee or vendor nor affect such mortgagee’s or vendor’s right to recover in case of loss on such real estate. . . .

This portion of the statute arguably renders ineffective Minnesota’s traditional simple loss payable form, when applied to secured loss payees such as mortgagees. Restated, the statutory policy holds that:

1) Notwithstanding, any other provision of the policy (any other terms or language to the contrary);
2) if this policy shall be made payable to a mortgagee (any mortgage holding loss payee);
3) no act or default of any person (fraudulent or negligent act of the insured)
4) shall render this policy void as to the mortgagee
5) nor affect such mortgagee’s right to recover (including subjecting it to the insurer’s defenses against the wrongful acts of the insured).

Hence, the distinction between simple and standard loss payee clauses becomes moot in cases where the named loss payee holds a mort-
gage to the insured property. Even if the mortgagee is identified as a simple loss payee in the contract and would otherwise be subject to the same defenses as the insured under the traditional loss payee theory, the fact that the contract is payable at all to the mortgagee places the contract under the controlling language of the statute. By the express terms of the statute, "no act or default of any person" (including the insured) shall affect the mortgagee's right to recover.

Policy language purporting to deny coverage to "any" insured on the basis of the acts of another insured places co-insureds beneath the minimum required coverage. Similarly, identifying a mortgagee as a simple loss payee, with only those rights derivative of the insured and subject to the same defenses as the insured, places the mortgagee beneath the minimum required coverage. Yet Krueger made clear that no fire insurance policy may provide less coverage than that afforded by the statutory policy. Thus, the effect of the statute is clear—mortgagees are to be protected from perils, including the wrongful acts of the insured.

It is important to recall that the Minnesota Standard Fire Policy is somewhat unique in this regard. While virtually all states have incorporated standard fire policies based on the New York form, very few contain the express language protecting mortgagees found in the Minnesota statute. Essentially, all states' standard policies include the standard or mortgage loss payee clause; they generally do so only in requiring a notice to the mortgagee of the insurer's intent to cancel the policy (generally for non-payment of premium by the insured). This statutory obligation of notice to the mortgagee becomes the basis of the contractual relationship between the mortgagee and the insurer, entirely independent of the rela-

288. See id. By definition a simple loss payable clause makes the policy payable to the named loss payee. See id. Thus, if the named loss payee is a mortgagee, the statute requires that no acts of the insured will void the policy as to that mortgagee. See id.
289. See id.
290. See id.
291. See Watson, 566 N.W.2d at 691; see also Minn. Stat. § 65A.01, subd. 3 (1998).
293. See Minn. Stat. § 65A.01, subd. 3.
294. See Committee on Property Ins. Law Tort and Ins. Practice Section, supra note 9, at 3.
296. See, e.g., N.Y. Ins. Law § 3404 (McKinney 1985) (stating only that "[i]f loss hereunder is made payable, in whole or in part, to a designated mortgagee not named herein as the insured, such interest in this policy may be cancelled by giving to such mortgagee a ten days' written notice of cancellation") (emphasis added). See also Conn. Gen. Stat. Ann. § 38a-307 (West 1992) (stating the text of the New York standard form verbatim).
tionship between insured and insurer, which supports the standard loss payable clause. 7

However, if statutory policies rely solely on the insurer's duty of notice to create the standard loss payable clause, it also routinely requires that the mortgagee must be identified for the notice requirement to apply. 298 This is what makes it possible for policies to incorrectly identify mortgagees as simple loss payees in so many jurisdictions. 299 If the lender is not designated as a mortgagee in the policy declaration, the insurer has no duty to notify the mortgagee of its intent to cancel the policy. 300 With no independent duty flowing from the insurer to the mortgagee, no privacy and therefore no basis for an independent contract between them exists. 301

Minnesota also requires that the lender be designated as mortgagee in order for the duty of notice to apply. 302 The statute requires that:

If loss hereunder is made payable, in whole or in part, to a designated mortgagee or contract for deed vendor not named herein as insured, such interest in this policy may be canceled

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297. See Steinmetz et. al., supra note 1, at 84-85.
298. See, e.g., N.Y. INS. LAw § 3404 (McKinney 1985). Mississippi is one of the few states, in addition to Minnesota, that includes an express mortgage clause in its statutory policy. See MISS. CODE ANN. § 83-13-9 (1998). It includes the following language:

Loss or damage, if any, under this policy, shall be payable to (here insert name of party), as mortgagee (or trustee), as interest may appear, and this insurance, as to the interest of the mortgagee (or trustee) only therein, shall not be invalidated by any act or neglect of the mortgagor or owner of the within described property, nor by any foreclosure or other proceedings or notice of sale relating to the property, nor by any change in the title or ownership of the property, nor by occupation of the premises for purposes more hazardous than are permitted in this policy; and in case the mortgagor or owner shall neglect to pay any premium due under this policy, the mortgagee (or trustee) shall, on demand, pay the same. . . . This company reserves the right to cancel this policy at any time as provided by its terms, but in such case this policy shall continue in force for the benefit only of the mortgagee (or trustee) for thirty (30) days after notice to the mortgagee (or trustee) of such cancellation and shall then cease, and this company shall have the right on like notice to cancel this agreement.

Id. 299. See supra notes 53-54.
300. See N.Y. INS. LAw § 3404 (McKinney 1985).
301. See 45 C.J.S. Insurance §§ 595, 638 (1993); 4 COUCH, supra note 7, § 65:24; 3 INSURING REAL PROPERTY, supra note 6, § 52.02[1]; Steinmetz et. al., supra note 1, at 83.
302. See MINN. STAT. § 65A.01, subd. 3 (1998).
by giving to such mortgagee or contract for deed vendor a ten
days' written notice of cancellation.\footnote{303}

However, this provision is not Minnesota's sole basis of the insurer's duty
to the mortgagee. The standard policy continues, "[n]otwithstanding any
other provisions of this policy, if this policy shall be \textit{made payable} to a
mortgagee or contract for deed vendor . . . .\footnote{304} The words "notwithstanding
any provisions" give this clause preeminence over the preceding
clause, which, for purposes of the notice requirement for intent to cancel,
is that the mortgagee be so designated.\footnote{305} The latter clause includes
no such requirement.\footnote{306} It merely requires that the policy be "made payable" to a mortgagee.\footnote{307} Thus, if a mortgagee, whether identified or not,
is listed in any manner as a loss payee, the statute dictates that such mort-
gagee is not subject to the defenses of the insurer against the wrongful
acts of the insured.\footnote{308}

When such a case comes before a Minnesota court in the future, the
court must abandon the precedents of \textit{Allen, Shepherdson, Young} and
\textit{Bast}.\footnote{309} The contract theory analysis no longer should be applied since it
can yield results contrary to Minnesota Statute section 65A.01.\footnote{310} Follow-
ing the outcomes of \textit{Krueger}\footnote{311} and \textit{Watson},\footnote{312} the court must look to the
statute for guidance.\footnote{313} If insurance proceeds are made payable in any
manner to a mortgagee, whether so identified in the policy declaration,
the court is constrained by the statutory fire policy to read the contract as
including a standard loss payable clause.\footnote{314}

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  \item \footnote{303} \textit{Id.} (emphasis added).
  \item \footnote{304} \textit{Id.} (emphasis added).
  \item \footnote{305} The term "notwithstanding" means "without prevention or obstruction
from or by; in spite of." \textsc{Webster's 3rd New International Dictionary} 1545 (3d
ed. 1993).
  \item \footnote{306} See \textsc{Minn. Stat.} § 65A.01, subd. 3 (1998).
  \item \footnote{307} See \textit{id}.
  \item \footnote{308} See \textit{id}.
  \item \footnote{309} See American Nat'l Bank & Trust Co. v. Young, 329 N.W.2d 805, 811
(Minn. 1983); H.F. Shepherdson Co. v. Central Fire Ins. Co., 220 Minn. 401, 405-
06, 19 N.W.2d 772, 775 (1945); \textit{Allen v. St. Paul Fire & Marine Ins. Co.}, 167 Minn.
146, 150, 208 N.W. 816, 818 (1926); \textit{Bast v. Capital Indem. Corp.}, 562 N.W.2d 24,
27 (Minn. Ct. App. 1997).
  \item \footnote{310} See \textsc{3 Insuring Real Property}, \textit{supra} note 6, § 52.02[3].
  \item \footnote{311} See \textit{Krueger v. State Farm Fire & Cas. Co.}, 510 N.W.2d 204, 208 (Minn. Ct.
App. 1993).
  \item \footnote{312} See \textit{Watson v. United Serv. Auto. Ass'n}, 566 N.W.2d 683, 691 (Minn.
1997).
  \item \footnote{313} See \textsc{Minn. Stat.} § 65A.01, subd. 3 (1998).
  \item \footnote{314} See \textit{id}.  
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V. CONCLUSION

Protecting interests in insurance benefits has evolved over time.315 The courts developed differing strategies to resolve questions of insurer liability to third parties and to multiple-named insureds.316 In addition to the question of coverage, i.e., who may benefit under an insurance policy, questions remain as to when and under what circumstances such parties legally are entitled to the policy proceeds.317

Courts have struggled with several issues when an innocent third party, or an innocent co-insured is denied coverage under the policy. For third party beneficiaries, particularly lender-mortgagees, the loss payable clause evolved.318 Traditionally, where the courts have found a contractual relationship between mortgagee and insurer, the mortgagee's interests have been deemed independent of the insured's rights.319 Thus, even if the policy is held void as to the insured, the mortgagee remains protected.320 Conversely, where no privity is found between mortgagee and insured, the mortgagee is held to "stand in the shoes" of the insured and is subject to the same defenses the insurer has against the insured.321 In this situation, the mortgagee recovers only if the insured recovers first.322

Recent Minnesota cases and cases in other states have taken a statutory approach to the similar question of whether innocent co-insureds should recover when another insured acted in violation of express policy terms.323 Where the language of the policy was found to place the co-insured beneath the minimum insurance coverage required by statute, such terms were nullified and the innocent co-insured was permitted to recover.324

315. See supra Parts II, III.
316. See supra Parts II, III.
317. See generally 3 INSURING REAL PROPERTY, supra note 6, § 52.01 (describing the evolution of loss payable forms); Cerven, supra note 8, at 851 (addressing the various approaches the courts have taken concerning the problem of innocent co-insureds).
318. See Richards, supra note 6, at 473; Steinmetz et. al., supra note 1, at 82.
319. See 46A C.J.S. Insurance § 1404 (1993); 5A Appleman & Appleman, supra note 33, § 3401; 4 COUCH, supra note 7, § 65:9 n.36; 3 INSURING REAL PROPERTY, supra note 6, § 52.01[1]; Steinmetz et. al., supra note 1, at 83.
320. See Steinmetz et. al., supra note 1, at 83.
321. See 4 COUCH, supra note 7, § 65:9 n.36.
322. See 45 C.J.S. Insurance §§ 595, 638 (1993); 4 COUCH, supra note 7, § 65:24; 3 INSURING REAL PROPERTY, supra note 6, § 52.01; Steinmetz et. al., supra note 1, at 82.
324. See Watson, 566 N.W.2d at 691.
A close reading of the Minnesota Standard Fire Policy indicates that courts in this state should take the same approach toward mortgagees.\textsuperscript{325} Minnesota law requires that policies of insurance afford no less coverage than that outlined in the statutory policy.\textsuperscript{326} The Minnesota statutory policy states that when a policy is made payable to a mortgagee, no act of any person (including the insured) shall void the policy as to the mortgagee.\textsuperscript{327} Thus, when a mortgagor is required by the terms of a mortgage agreement to procure property insurance payable to the mortgagee and the mortgagor-insured later violates the terms of the policy, the policy must be read to include a standard mortgage clause.\textsuperscript{328} When faced with the problem of a mortgagee misidentified in an insurance policy as a simple loss payee, the Minnesota courts should follow the statutory analysis used by the \textit{Watson} court.\textsuperscript{329}

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\item \textsuperscript{325} See \textsc{Minn. Stat.} § 65A.01, subd. 3 (1998).
\item \textsuperscript{326} See \textit{id.} subd. 1; Krueger v. State Farm Fire & Cas. Co., 510 N.W.2d 204, 209 (Minn. Ct. App. 1993).
\item \textsuperscript{327} See \textsc{Minn. Stat.} § 65A.01, subd. 3.
\item \textsuperscript{328} See \textit{Watson}, 566 N.W.2d at 691.
\item \textsuperscript{329} See \textit{id.} at 689-91.
\end{enumerate}
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