

Author:

Phillip H. Hecht
+1.202.778.9380
phillip.hecht@klgates.com

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Tennessee Supreme Court Holds That Commencement of Foreclosure Doesn't Foreclose Hazard Insurance Claim

On January 29, 2009, the Tennessee Supreme Court held that a mortgage lender is not required to give notice to a hazard insurer when the lender commences foreclosure proceedings.¹ The Supreme Court's decision reversed the Tennessee Court of Appeals' December 21, 2007 decision holding that the lender's initiation of foreclosure proceedings constituted an "increase in hazard" under the policy, and that the lender's failure to give notice of the foreclosure proceedings to the insurer invalidated coverage.²

U.S. Bank, N.A. v. Tennessee Farmers Mutual Ins. Co. concerned a dispute between an insured mortgage lender and the insurer that had issued a policy of hazard insurance on a residence that burned after the lender had begun foreclosure proceedings on the property. The lender had not notified the insurer of the foreclosure proceedings. The insurer denied coverage on the grounds that commencement of foreclosure proceedings constituted an "increase in hazard" that required notice under the policy's standard mortgage clause.

The Tennessee Court of Appeals - in the first such decision in decades - held that foreclosure proceedings create a "potential increase of risk to [the insurer]" because of the "mortgagor's incentive to destroy the house intentionally to receive the proceeds of the insurance policy" [cite], and that the "risk begins with the initiation of foreclosure proceedings and ends when the foreclosure process is complete."³

In reversing the Tennessee Court of Appeals' decision, the Tennessee Supreme Court stated: "We decline to assume that the mere commencement of foreclosure proceedings, by itself, automatically constitutes an increase in hazard which, in the absence of specific policy language so providing, warrants defeating the insurance coverage . . . we are not willing to assume, absent proof, that a homeowner facing a foreclosure sale will set fire to his or her property for monetary gain."⁴ The Supreme Court further stated that it would not "read into this policy an obligation to notify the insurer of the commencement of foreclosure" where the insurer could have included that obligation explicitly but did not do so.⁵ Finally, the Supreme Court reviewed the Tennessee insurance statute and held that, because "there is no substantive difference between the requirements of the statute and the standard mortgage clause," it would not interpret the statutory language and policy language differently.⁶

1 *U.S. Bank, N.A. v. Tennessee Farmers Mutual Ins. Co.*, No. W2006-02536-SC-R11-CV (Tenn. Sup. Ct. Jan. 29, 2009) (slip op.)

2 *U.S. Bank, N.A. v. Tennessee Farmers Mutual Ins. Co.*, No. W2006-02536-COA-R3-CV, 2007 WL 443959 (Tenn. Ct. App. Dec. 21, 2007).

3 *Id.* at *8, quoting *Provident Bank v. Tenn. Farmers Mut. Ins. Co.*, 234 F. App'x 393, 397 (6th Cir. 2007).

4 *U.S. Bank*, slip op. at 8.

5 *Id.*

6 *Id.* at 10.

The Tennessee Supreme Court's decision is consistent with judicial decisions in other jurisdictions holding that standard mortgage clauses contained in many current fire and extended coverage insurance policies do not require mortgage loan holders to give notice of foreclosure proceedings to their hazard insurers.

Given the ever-increasing number of foreclosures, this decision offers potential relief from further administrative burdens to already burdened loan servicers.

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For more information, please contact one of the professionals listed below.

LAWYERS

Boston

R. Bruce Allensworth	bruce.allensworth@klgates.com	+1.617.261.3119
Irene C. Freidel	irene.freidel@klgates.com	+1.617.951.9154
Stephen E. Moore	stephen.moore@klgates.com	+1.617.951.9191
Stanley V. Ragalevsky	stan.ragalevsky@klgates.com	+1.617.951.9203
Nadya N. Fitisenko	nadya.fitisenko@klgates.com	+1.617.261.3173
Brian M. Forbes	brian.forbes@klgates.com	+1.617.261.3152
Andrew Glass	andrew.glass@klgates.com	+1.617.261.3107
Phoebe Winder	phoebe.winder@klgates.com	+1.617.261.3196

Charlotte

John H. Culver III	john.culver@klgates.com	+1.704.331.7453
--------------------	-------------------------	-----------------

Los Angeles

Thomas J. Poletti	thomas.poletti@klgates.com	+1.310.552.5045
-------------------	----------------------------	-----------------

Miami

Paul F. Hancock	paul.hancock@klgates.com	+1.305.539.3378
-----------------	--------------------------	-----------------

New York

Philip M. Cedar	phil.cedar@klgates.com	+1.212.536.4820
Elwood F. Collins	elwood.collins@klgates.com	+1.212.536.4005
Steve H. Epstein	steve.epstein@klgates.com	+1.212.536.4830
Drew A. Malakoff	drew.malakoff@klgates.com	+1.216.536.4034

San Francisco

Jonathan Jaffe	jonathan.jaffe@klgates.com	+1.415.249.1023
Erin Murphy	erin.murphy@klgates.com	+1.415.249.1038

Seattle

Holly K. Towle	holly.towle@klgates.com	+1.206.370.8334
----------------	-------------------------	-----------------

Washington, D.C.

Costas A. Avrakotos	costas.avrakotos@klgates.com	+1.202.778.9075
Melanie Hibbs Brody	melanie.brody@klgates.com	+1.202.778.9203
Daniel F. C. Crowley	dan.crowley@klgates.com	+1.202.778.9447
Eric J. Edwardson	eric.edwardson@klgates.com	+1.202.778.9387
Anthony C. Green	anthony.green@klgates.com	+1.202.778.9893
Steven M. Kaplan	steven.kaplan@klgates.com	+1.202.778.9204
Phillip John Kardis II	phillip.kardis@klgates.com	+1.202.778.9401
Rebecca H. Laird	rebecca.laird@klgates.com	+1.202.778.9038

Laurence E. Platt	larry.platt@klgates.com	+1.202.778.9034
Phillip L. Schulman	phil.schulman@klgates.com	+1.202.778.9027
H. John Steele	john.steele@klgates.com	+1.202.778.9489
Ira L. Tannenbaum	ira.tannenbaum@klgates.com	+1.202.778.9350
Nanci L. Weissgold	nanci.weissgold@klgates.com	+1.202.778.9314
Kris D. Kully	kris.kully@klgates.com	+1.202.778.9301
Morey E. Barnes	morey.barnes@klgates.com	+1.202.778.9215
David L. Beam	david.beam@klgates.com	+1.202.778.9026
Emily J. Booth	emily.booth@klgates.com	+1.202.778.9112
Holly Spencer Bunting	holly.bunting@klgates.com	+1.202.778.9853
Krista Cooley	krista.cooley@klgates.com	+1.202.778.9257
Elena Grigera	elena.grigera@klgates.com	+1.202.778.9039
Melissa S. Malpass	melissa.malpass@klgates.com	+1.202.778.9081
David G. McDonough, Jr.	david.mcdonough@klgates.com	+1.202.778.9207
Stephanie C. Robinson	stephanie.robinson@klgates.com	+1.202.778.9856
Kerri M. Smith	kerri.smith@klgates.com	+1.202.778.9445
David Tallman	david.tallman@klgates.com	+1.202.778.9046

DIRECTOR OF LICENSING

Washington, D.C.

Stacey L. Riggin	stacey.riggin@klgates.com	+1.202.778.9202
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REGULATORY COMPLIANCE ANALYSTS

Washington, D.C.

Dameian L. Buncum	dameian.buncum@klgates.com	+1.202.778.9093
Teresa Diaz	teresa.diaz@klgates.com	+1.202.778.9852
Jennifer Early	jennifer.early@klgates.com	+1.202.778.9291
Robin L. Gieseke	robin.gieseke@klgates.com	+1.202.778.9481
Allison Hamad	allison.hamad@klgates.com	+1.202.778.9894
Joann Kim	joann.kim@klgates.com	+1.202.778.9421
Brenda R. Kittrell	brenda.kittrell@klgates.com	+1.202.778.9049
Dana L. Lopez	dana.lopez@klgates.com	+1.202.778.9383
Patricia E. Mesa	patty.mesa@klgates.com	+1.202.778.9199
Jeffrey Prost	jeffrey.prost@klgates.com	+1.202.778.9364

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