FORECLOSURE CLAIMS IN OHIO – WHAT DOES AN INSURER OWE AND TO WHOM?

"WHAT YOU NEED TO KNOW AND PITFALLS TO AVOID"

Matthew J. Smith, Esq.

CINCINNATI, OH | COLUMBUS, OH | DETROIT, MI | FT. MITCHELL, KY | ORLANDO, FL | SARASOTA, FL

www.smithrolfes.com

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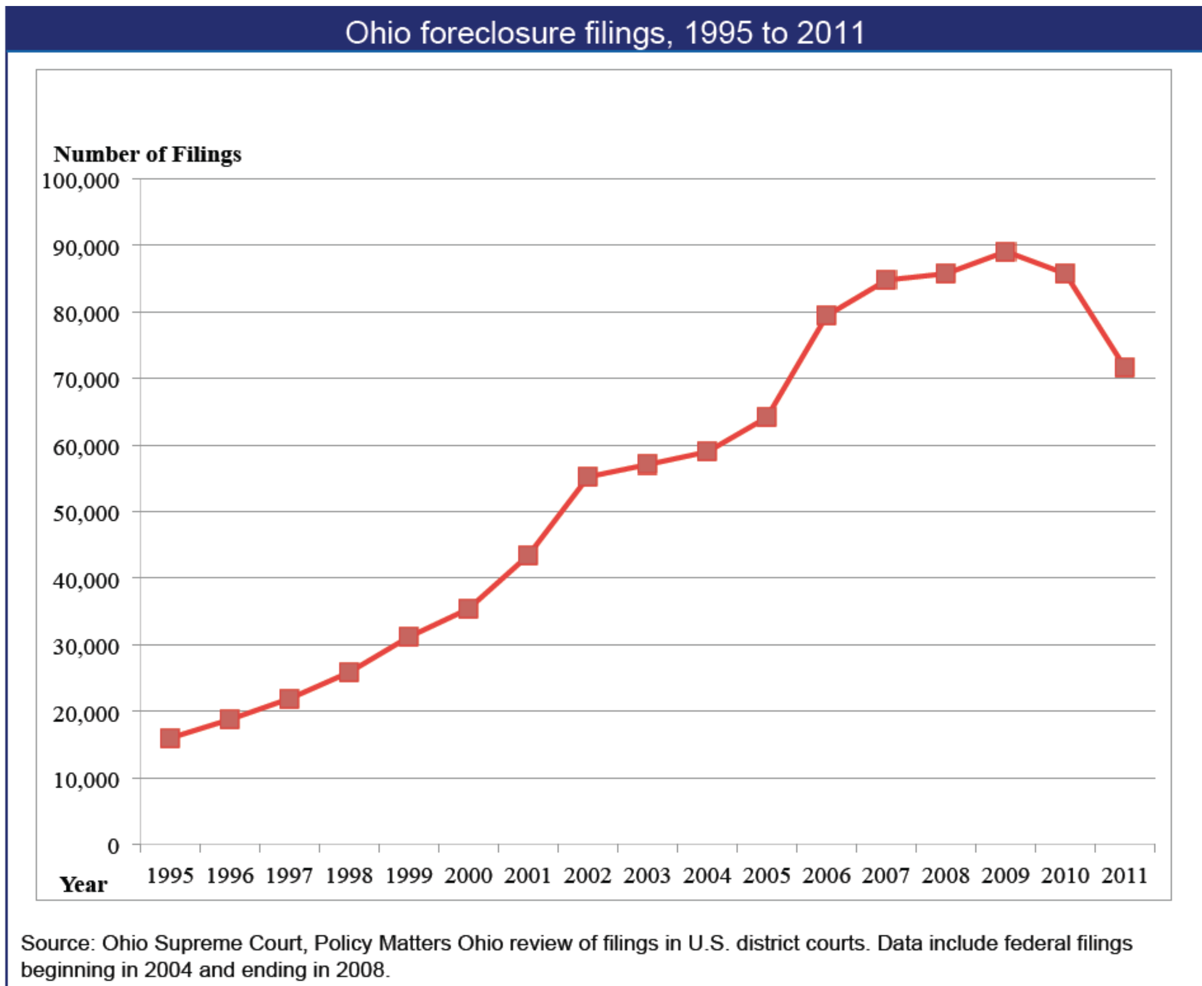
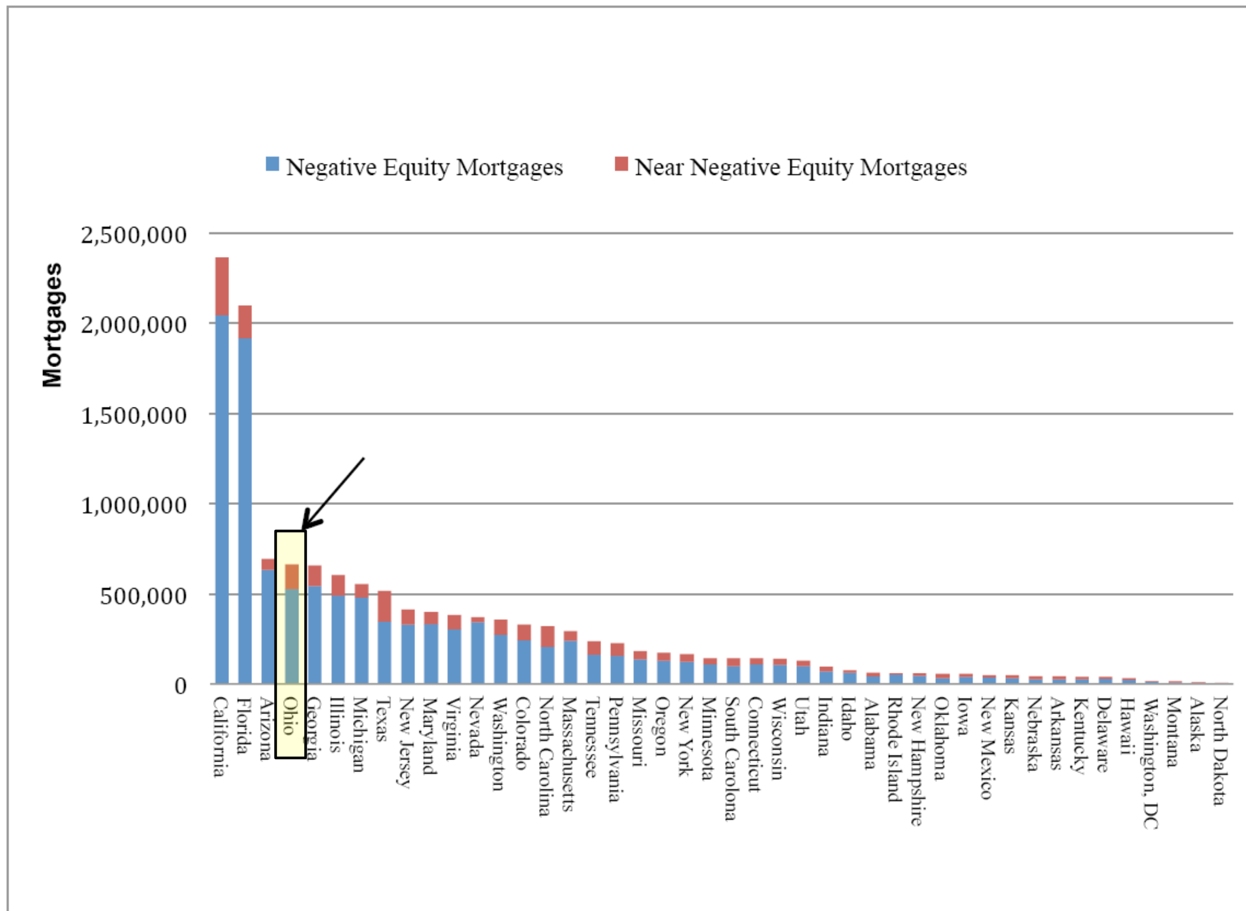
I. Introduction and Overview of the Problem

While it is common knowledge "every bubble will burst," few correctly predicted the severity of the economic crash of the "Great Recession." Traditionally, industrial states such as Ohio were, and remain, among the hardest impacted. Like dominoes falling, the loss of investment income and employment imploded with the overpriced housing market. The result was the largest number of foreclosure filings in the history of our country and our state. While in the past two years the number of foreclosure filings has finally begun to decline, the net result of total filings is still staggering, hovering above seventy thousand compared to fewer than twenty thousand less than two decades ago. The chart below, prepared by our own Ohio Supreme Court, demonstrates the dramatic rise of mortgage foreclosure filings in the Buckeye State.



While as early as 2007, the real estate collapse in the State of Florida was signaling problems with the housing market, few heeded the warning call. Increasingly, during the preceding decade, Ohio's farmland became areas of new suburban sprawl growth. In my hometown of Cincinnati, I personally watched multi-million dollar homes built overlooking the rear loading dock of a Wal-Mart. I recall reading an article shortly before the collapse where two of these homes were bought by an extremely poor woman living in the inner city with minimal income. She was set up as a "straw" buyer for these multi-million dollar homes.

Rampant practices such as these led to Ohio being fourth in the entire nation in negative equity in homes. It is much easier to understand why the three states listed above Ohio (California, Florida and Arizona) may have been overbuilt in the early part of the new millennium and late 1990's due to the influx of baby boomer retirees in those states. There can be little question the "epicenter" of much of the mortgage fraud occurring in the country occurred right here at home in Ohio. The following graph demonstrates very clearly that while the raw numbers of negative equity in Florida and California are astounding, Ohio is one of the leading states in the country for this unfortunate statistic.



Source: Core Logic, Negative Equity Q4 2011

The events of the last several years have created grave questions for insurance companies and insurance attorneys alike regarding the impact of foreclosures on insurance claims. The reality is most coverages available under an HO policy are neither complicated nor involved and have certainly been handled by insurance companies and their legal counsel for decades. Even the most simple water loss, however, can become a claims or legal nightmare when the property is embroiled in a foreclosure proceeding. There is no "simple" insurance claim when multiple parties are seeking recovery for proceeds or arguing over equitable or legal ownership of the property and the insurance claim or payments. Perhaps more than any other insurance law issue in the past five to seven years, this has been the most pressing, complicated and misunderstood.

II. Breaking Down the "Mystery" of Foreclosure

To begin to unravel this legal "knot," both insurers and their counsel must have a basic understating of the terms, procedures and processes at issue. All too often, mistakes are made because of a lack of clear understanding of what foreclosure actually means, or the legal ramifications which arise at various stages of the foreclosure process. Perhaps the most basic thing to understand is what foreclosure itself means. In this new electronic era, we no longer routinely look to *Black's Law Dictionary*. Instead, *Wikipedia* defines foreclosure as follows:

> *Foreclosure is the legal process in which a lender attempts to recover the balance of a loan from a borrower who has stopped making payments by forcing the sale of the asset used as collateral for the loan.*
>
> *The foreclosure process for residential mortgage loans is a bank or other secured creditor selling or repossessing the real property after the owner has failed to comply with the "mortgage" or "deed of trust." When the process is complete, the lender can sell the property and keep the proceeds to pay off its mortgage and any legal costs.*

While it may seem to be an uncanny analogy, one of the most important things to understand is "foreclosure" is like pregnancy! You are either pregnant or you are not, and there is no middle ground. Too often, insurance adjusters and even attorneys do not fully appreciate foreclosure is actually a legal process which only truly begins with the filing of the foreclosure complaint in the common pleas court. We have handled a number of claims where insurers felt "fraud" had been committed because they asked the insured in a recorded statement, or even in an Examination Under Oath, whether the property was in foreclosure and received the answer

"no." In each of these claims, the lender had sent multiple notices of deficiency on the mortgage, and in some cases even had invoked the demand to vacate the property for non-payment. The insurers and even attorneys mistook these "steps" as meaning the property was in "foreclosure." In contrast, the insureds claimed they answered the question 100% truthfully because no actual foreclosure proceeding had been filed against them in the court. In each of these claims, the insurance company or their selected legal counsel simply failed to ask the right and complete question, giving the insured the opportunity to "wiggle" and answer truthfully, but not disclose necessarily complete or accurate information.

A. Ohio Law on Foreclosure

In Ohio, foreclosure is a statutory process set forth at ORC §2323.07. In its most simplistic nature, the following five steps define foreclosure under Ohio law:

1. A foreclosure complaint is filed in common pleas court with 28 days to file an answer or a default judgment is entered. If an answer is filed the case is adjudicated by summary judgment or trial. Once adjudicated, a decree is entered and the sheriff is directed to hold a foreclosure sale.
2. Three disinterested freeholders provide an appraisal of the value of the property. The property cannot be offered for less than 2/3 of the appraisement.
3. The foreclosure sale is advertised 30 days in advance of the sale and must occur once per week for 3 weeks before the sale.
4. The sheriff handles foreclosure sales which take place at the courthouse. The sheriff returns a writ of execution indicating the sale has taken place. The court determines the sale has been undertaken legally which is called a confirmation.

5. Ohio has a statutory right of redemption, allowing a party whose property has been foreclosed to reclaim by making payment in full of the unpaid loan plus costs. Redemption must occur before confirmation of the of the foreclosure sale by the court. Once confirmation occurs any right of redemption is extinguished and a deed is issued to the purchaser who often is the lienholder.

It is important to note, especially steps four and five are a great protection to Ohio insurers as unlike other states, the right of redemption does not continue for a specifically stated statutory time length. Instead, it is extinguished once the court issues confirmation of the foreclosure sale. Once final confirmation is entered by the court, the prior owner (named insured) will have no right to redeem or repurchase the property.

B. Understanding Key Foreclosure Terms

Along the path of foreclosure, it is also important to understand other key terms and their relationship to the insurance contract. Oftentimes, terms in an insurance policy, or related to insurance coverage, are confusing even to those routinely involved in their application. Normally, the person who is entitled to payment in a foreclosure proceeding will be making a claim as a "lienholder" or "loss payee" under the policy. These terms are similar, but also may have important differences. *Dictionary.Com* defines a lienholder as follows:

> *A person who retains legal possession of a piece of property until the person to whom he/she has advanced money for use of the property has satisfactorily repaid the debt.*

As this definition clearly states, a lienholder is a person who possesses a legal interest in the property by virtue of a mortgage or deed of trust given by the property owner to the person, and

normally in exchange for the receipt of money to either purchase the property, or for other purposes in the situation of the refinancing of a property where equity is taken in the form of a cash payment.

A lienholder may be vastly different from a loss payee, and this term is defined by *Investopedia* as follows:

> *The party to whom the claim from a loss is to be paid. Loss payee can mean several different things; in the insurance industry, the insured or the party entitled to payment is the loss payee.*

The primary difference is a loss payee is simply a person who, for whatever reason, is named on the insurance policy as a party to receive payment in the event of coverage being due and owing, whether or not that person may possess a legal or mortgage interest in the property.

A third type of claimant also arises in the form of an "additional insured." The International Risk Management Institute provides the following definition of an additional insured:

> *A person or organization included as an insured, but for whom the named insured desires or is required to provide protection under its insurance policy. Reasons may include a close relationship with that party or to comply with a contractual agreement requiring the named insured to do so.*

In most situations, an additional insured is added to the policy purely for liability coverage purposes, and not to protect an ownership or financial interest in the property. In most situations, where an additional insured would be listed on a homeowner or commercial policy, and an actual

claim for damage to the structure or contents of the property is made, the additional insured will release or waive any entitlement to compensation. Even in these situations, however, it is important for the insurance company or their legal counsel to make certain the additional insured is either joined on the check pursuant to the policy terms and conditions or has executed a proper waiver of any entitlement to payment.

C. Impact of the "Mortgage Clause"

Returning to the lienholder status under the policy, which is going to be the normal situation involving a foreclosure, the issue then becomes: *under what policy provision or circumstance does the lienholder have a right to payment pursuant to the policy?* Virtually every policy approved by the State of Ohio and issued to Ohio policyholders contains a mortgage clause. At its basic foundation, *Lawers.Com* defines a mortgage clause as follows:

> *A mortgage clause is usually considered to form a separate contract between the insurer and mortgagee under which the mortgagee can collect payment even if the policy is void or voidable with regard to the insured (as because of fraud or nonpayment).*

The mere fact a policy contains a mortgage clause does not answer the question fully as to what the rights are of the lienholder under the policy. The Ohio courts recognize two different types of mortgage clauses, although one is much more prevalent than the other.

The first type of mortgage clause which is rarely, if ever, found in any homeowner policy is what is called an "open" loss payable clause. An open mortgage clause simply states "a loss is payable as the interest shall appear" and merely identifies the person who may collect the

proceeds under the insurance policy. This is not a favored type of mortgage clause by banks or other lending institutions as it does not fully and completely protect their rights, and only gives them a right to basically be listed as an additional payee on a check (*i.e.* a loss payee) rather than having the much higher level of coverage afforded under the second type of mortgage clause.

The most common form of mortgage clause found in any jurisdiction, and especially in Ohio, is what is called the "union standard" or "New York" mortgage clause. In this type of mortgage provision:

> *The owner/mortgagor's acts or neglect will not invalidate the insurance provided if the owner/mortgagor fails to pay premiums due, the lienholder/mortgagee shall on demand pay the premiums.*
>
> *Progressive Am. Ins. Co. v. Florida Bank at Daytona Beach,* 452 So.2d at 44 (Fla. 5th DCA 1984); *Independent Fire Insurance Co. v. NCNB National Bank of Florida,* 517 So. 2d at 61 (Fla. 1st DCA 1987); 5A J. Appleman, *Insurance Law Practice* Sec. 3401 (1970)

Most commonly, this type of mortgage clause creates what is known as a "contract within the contract" affording the lienholder the full right to seek recovery under the insurance contract regardless of any intentional acts, fraud or misrepresentation engaged in by the named insured. While often lienholders will argue the "contract within the contract" also does not obligate them to submit to any conditions, duties or responsibilities under the contract, most courts will look at this as an equitable issue and will hold the mortgage company responsible to act within all reasonable terms and conditions of the contract.

III. Determining Who is Owed on a Loss

One of the most perplexing issues facing insurers is: *who is entitled to compensation once the property actually goes to foreclosure sale?* To make the correct decision you must analyze the policy, determine the "status" of the person or entity seeking coverage and payment, and then analyze what the legal rights of that party are under the policy and Ohio law. Confusion often occurs because claims may be made to the insurer by differing parties with substantially differing legal and policy rights, or none at all. We will try to cover the most common types of claims for payment which you may encounter.

A. The Third Party Foreclosure Purchaser

The first issue to address is if the property is purchased by an independent third party at the foreclosure sale. Although this may appear to be obvious, it is not unusual to receive inquiries from insurers asking whether any policy benefits are due and owing to the third party purchaser. The simple answer to this question is "no." When a foreclosure sale is made to a third party and then confirmed by the court, any rights of the named insured or the loss payee are extinguished under the insurance contract, and no benefits are due and owing to the third party purchaser.

One possible exception is if the third party purchaser claims to have received an "assignment" of the insurance contract from either the named insured or the lienholder. Most standard policies do not permit assignability of the insurance contract, and in these limited circumstances the insurance policy should be carefully reviewed to determine whether the assignment was valid. Certainly an insurer may elect to honor an assignment of an insurance policy or benefits, although those circumstances should certainly be rare. There is nothing in

Ohio law which prohibits an insurer from allowing an insured or lienholder to assign coverage under the policy or payment for a loss to a third party, but this should be approached with extreme caution.

B. A Lienholder NOT Named on the Policy

A second issue may arise in a situation where a lienholder purchases the property, but is not listed on the insurance policy either as a lienholder or loss payee. In this circumstance, basic contractual provisions apply and those who are not a party to the contract are not entitled to its benefits. The mere fact an individual or corporation has a valid lien against a property does not automatically make them a lienholder or loss payee under the insurance contract. The rights of an individual or business to be named on the insurance contract arise within the policy terms, conditions and declarations themselves and not simply by recording a mortgage or lien with the county recorder's office.

As a general rule, insurers will not owe a lienholder for a claim when that lienholder is not specifically named on the insurance policy. There may again be issues of assignment which need to be considered. In an abundance of caution, if after a valid covered loss occurs the insurer learns of a previously unidentified lienholder having a legal interest in the property, oftentimes it is wise to join that additional lienholder party on any settlement check. The carrier is now on constructive notice of the lien even if the lienholder is not officially listed on the policy.

C. The Rights and Duties of a Listed Lienholder

This leaves the more complicated question: *what rights does a lienholder have under the insurance contract once the property has gone to foreclosure sale and confirmation?* As previously noted, the issue of the "contract within the contract" does bring into question what rights, duties and responsibilities a lienholder may have and what policy exclusions, if any, may apply. Most courts have determined provisions such as the vacancy clause, material change in condition or use, and even material misrepresentation provisions do apply to a lienholder. As a general rule, a lienholder should not be afforded any greater rights of coverage or lesser responsibilities than placed upon the named insured.

Especially with the rise in foreclosure litigation in the State of Ohio in recent years, we have encouraged our clients to invoke provisions of the policy which reasonably require documentation to be provided for the proper adjustment of a claim. Such documents may include:

1. Pre-loss inspection reports of the property
2. Appraisals to support mortgage amount
3. Photographs of pre-loss condition of the property
4. Reports on vacancy

D. Be Cautious of Mortgage Transfers

It is also extremely important to review the policy carefully to determine who is actually listed as the named lienholder. In this era of banks transferring mortgages and frequently changing corporate names, it is not uncommon for insurers to issue payments which are not

actually due and owing. When an insurer transfers a mortgage to a separate or different corporate entity, it is incumbent upon the lienholder to notify the insurer and request the new entity be listed correctly on the policy. Many banks and financial institutions fail to do this and may well be in breach of the policy since transfer of the mortgage interest to a new corporation extinguishes any right the actual named lienholder has under the insurance contract. Insurers are wise to carefully pay attention to what entity actually legally owns the mortgage at the time of loss to determine whether any benefits are due and owing.

E. Determining the Amount of Loss Due and Payable

The next issue we must address is if a claim is owed to the lienholder, what amounts are owed. Frequent questions often arise as to whether a lienholder may recover only the actual cash value (ACV) or full replacement cost value (RCV) of the property. Most policies also contain a provision for a deadline by which RCV coverage must be recovered, and polices and case law are silent on whether that period is extended for a property in foreclosure and begins to "run anew" when the foreclosure sale is complete. Our Firm has traditionally taken the position a lienholder's rights are no greater than the named insured and any time limit or provision for RCV coverage from the date of loss should be construed to apply to the lienholder as well as the named insured regardless of the status of any foreclosure proceeding.

Even when this hurdle is covered, questions still remain. These include determining if a lienholder should recover:

- Amount of the loss?
- Total amount of the mortgage?

- What if the amount of the lien is less than the ACV damage?
- RCV?
- Late fees, penalties and accrued interest?

F. Application of the Intentional Acts Exclusion

Before addressing these questions, we also need to return to the issue of whether a lienholder may recover if the named insured intentionally damages the property during a foreclosure proceeding. The highly equivocal answer to this question is simply "maybe."

The argument against coverage is: if the policy provides an intentional act by *any* insured voids coverage to *any* other insured, then the intentional acts exclusion should apply. The contrary argument goes back to the issue of the "contract within the contract" and holds the intentional acts exclusion does not apply to prohibit coverage to the lienholder even if the named insured acts intentionally to damage the property. Ohio courts have generally tended to favor coverage for lienholders by not applying the intentional act exclusion regardless of the language used to void coverage to any other insured. It should be noted this is an ongoing challenge in the Ohio court system, and many insures are becoming much more aggressive in arguing these cases throughout the state.

Regardless, there are several important considerations to keep in mind. First, even if coverage is due and owing, damage to the structure is the most which would be owed. Frequently, properties which are in foreclosure become the subject of intentional acts by the named insured, including removal of appliances. In one truly bizarre case we handled, the

insured removed an extremely expensive custom-made kitchen, completely reinstalled it at his new home in Florida, but replaced the kitchen in the foreclosed property with much cheaper cabinetry, countertops and appliances. The court ruled in our favor, holding although these were fixtures, the insured had every right to tear out and replace the fixtures (whether an upgrade or a downgrade) until such time as the foreclosure proceeding was finalized.

G. The Policy Insures the Property and NOT the Mortgage

Also in regard to these foreclosure claims, it is important to remember normally the lienholder is only entitled to be compensated to the extent of their mortgage lien. Insurance policies insure the structure and not the mortgage amount. We still receive a number of inquiries asking whether the full mortgage amount must be paid even if the damage is less than the amount of the mortgage. If the foreclosure has gone through confirmation and the lienholder is the true legal owner of the property, then they may recover for the full amount of damages. Depending upon the policy language, they may even be able to recover the full RCV amount if they comply with the policy terms and conditions, and replace or rebuild the structure.

If, however, confirmation has not yet occurred at the time of the loss, then the lienholder's amount of damage in no manner should exceed the amount of mortgage interest in the property. Most often, this calculation should be based solely on the ACV of the loss. If the ACV exceeds the amount of the mortgage, only the amount of the mortgage should be due and owing to the lienholder. The rationale being the lienholder has been fully compensated to the full extent of their financial interest in the property. It is also important to remember any amount paid to the lienholder prior to confirmation for the foreclosure should reduce on a "dollar for

dollar" basis the amount of the lienholder's financial interest in the property for purposes of the pending foreclosure action.

H. An Insurer's Right to a Mortgage Assignment

Oftentimes, insurers overlook the fact they have the right to take an assignment of a mortgage in exchange for payment of the lienholder interest. While many foreclosed properties may be in distressed areas of our state, there are certain properties for which it may be strategically and financially advantageous for the insurer to keep the option of taking an assignment of the mortgage, and then proceeding to resell the property when it is free and clear of any other liens. In situations involving intentional act damage by the named insured where coverage is still due and owing to the lienholder, insurers may well possess a right of subrogation recovery against the named insured for their actions and, if financial assets exist, can recover the amount paid to the lienholder from the named insured.

IV. Full and Partial Credit Bids

For properties which have gone thought the foreclosure process after the date of loss and where the lienholder is the successful high bidder at the Sherriff's sale, the amount bid by the lienholder has a dramatic impact upon the amount the insurance carrier owes. In situations where a lienholder purchases property which has been damaged by a covered loss, the lienholder may purchase the property by using either a full credit bid or a partial credit bid. These terms are defined as follows:

- Full Credit Bid - *a bid equal to the unpaid principal and interest on the mortgage debt plus costs, fees and expenses related to the foreclosure suit, i.e. the MAXIMUM or FULL amount due to the lender.*
- Partial Credit Bid - *a bid made by the mortgagee at the foreclosure sale for LESS THAN the full amount claimed due and owing in the pending foreclosure case.*

If the foreclosure is complete after the date of loss and the lienholder buys the property for a full credit bid, they may not also recover under the insurance policy. The reason is the foreclosure terminates all of the named insured's interest in the property and when the court confirms the purchase, the lienholder has then been "fully compensated" for their loan. The property, even in a damaged condition, obviously exceeded the value of the loan or it is presumed the lienholder would not have issued a full credit bid.

If the foreclosure sale, however, is completed after the date of loss and the lienholder is the successful high bidder at the Sheriff's sale, but uses only a partial credit bid, they may still recover under the policy, but only up to the difference between the partial bid amount and the available policy limits or amount of ACV damage, whichever is less. An example of a partial credit bid and what would be due and owing is as follows:

- Amount of loan plus costs: $100,000.00
- Pre-foreclosure loss damage: $75,000.00
- High partial bid at foreclosure sale: $60,000.00
- Lienholder may recover only: $40,000.00

The rationale behind this process is the assumption the property actually sold for less than the full credit bid because of the damage to the property. The lienholder may accordingly collect the difference between the amount of the bid and the available policy limits for the remaining "damage."

It is important to note there is a distinction if the foreclosure sale is complete before or after the date of loss. If the loss occurs after the foreclosure sale has been completed, the lienholder is now the legal owner of the property. By virtue of the foreclosure sale and confirmation, the full insurable interest in the property now "vests" in the lienholder as the legal owner in fact. The lienholder may be able to recover up to the full ACV or RCV value of the loss.

In any of these proceedings, it is vitally important for the insurance company and its personnel to know what specific duties and responsibilities are contained in the insurance contract, and which the lienholder must still comply with, to affect coverage. These may include provisions such as:

- The duty to notify the carrier in the event of a change of legal ownership;
- Any substantial change in risk associated with the property;
- And whether the policy vacancy exclusion may apply.

V. The Vacancy Clause Exclusion

Losses to vacant property involving an insurance carrier and a lienholder have long been litigated in the State of Ohio. As far back as 1885, the Ohio Supreme Court ruled:

A vacancy condition that declares a policy to be void when vacant or left unoccupied is absolute.

Farmers Ins. Co. v. Wells, 42 OhioSt.519 at 521 (1885)

The question then becomes: *What does the term "vacancy" actually mean?* The court will first look to whether the policy itself defines the term "vacant" or "vacancy" and if not, perhaps the most common definition is:

When the terms of the insurance policy do not define "vacant", the term is construed as "generally empty or deprived of contents".

47 A.L.R. 398

Definitions themselves, however, do not prove or disprove whether the property was vacant. Most of us in the insurance law profession have seen countless reports in the past several years by mortgage "inspection" companies claiming the property was "occupied" when the only evidence was something like an old rusted-out bicycle leaning against the garage wall, or a series of advertising flyers stuck on the front door or mailbox. We have frequently litigated whether such "evidence" truly constitutes occupancy to prove the property was not vacant. *Ohio Jurisprudence* is very helpful in supporting such arguments on behalf of insurance carriers as it states the following:

A dwelling house is vacated or unoccupied within the meaning of a condition against vacancy by the permanent removal therefrom of the regular occupants, even though a few articles are left on the premises or occasional or limited use is made of the insured dwelling.

58 Ohio Jur 3d. Insurance

We normally recommend to Ohio insurers they vigorously contest the issue of the vacancy exclusion if there is evidence the lienholder was clearly on notice the property was vacant and not occupied. Oftentimes, lienholders will also argue the frequent 60 day period of vacancy should start anew once the lienholder forecloses on the property. We again have taken a strong argument against such a position as not being contained within the terms and conditions of the insurance contract. Insurance carriers will also find themselves on the defensive in many of these types of claims based upon the common provision in many homeowner policies stating a vacancy does not include a property "under construction or remodeling." We have again repeatedly litigated this issue with claims as ridiculous as partially-installed linoleum flooring in a small utility room showing evidence the property was being "remodeled."

Of more significant impact is the argument of whether a vacancy provision applies to a fire loss claim versus a theft, water damage or similar loss. We have frequently litigated this issue, but found ourselves unfortunately more often on the losing end than the prevailing in Ohio courts.

The common argument as to why a fire loss is still a covered claim notwithstanding the property having been long vacated is the traditional contention fire is a separate peril set forth in the insurance contract. While some policies are beginning to be better written, most standard policies invoke the vacancy provision only in regard to claims of vandalism. This has allowed lienholders and others to make successful arguments the exclusion only applies to vandalism, and fire is a separate covered peril. In contrast, the argument we have made with some success

(and which to me continues to make full logical sense) is unless an act of arson is committed by the named insured or lienholder (which would be an intentional act) any third party who committed the act of arson had to first "vandalize" the property by illegally entering on the premises or the act or arson could have never been committed in the first place!

Insurance carriers also need to be cautious and make certain they do not inadvertently waive a vacancy provision due to their own actions or the acts of their agent. Ohio courts have held an insurance company may waive the vacancy exclusion by way of implication if the insurance company, or its agent, is shown to have had notice the property was vacant and the insurance carrier took no steps to cancel or void coverage. One of the strongest arguments for this is if the insurance carrier or its agent knew of the vacancy, they benefited by continuing to accept insurance premiums even though the property was no longer inhabited.

Insurers who wish to contest the vacancy provision under their policy oftentimes should look to the lienholder's own file records and their duty to cooperate in the investigation, produce records and documents, and even to submit to Examinations Under Oath as being perhaps the best evidence to prove the lienholder was well aware of the property being vacant. Documents such as the foreclosure proceedings, court records and even potential discovery in the foreclosure case all may tend to prove the lienholder understood the property was vacant. Additionally, inspection reports and evidence of utilities being turned off, or the lienholder listing the property on its own or other websites for sale, may all be compelling evidence to submit to a court to show the lienholder knew the property was unoccupied.

VI. Additional Duties of the Insurer Involving Foreclosure Claims

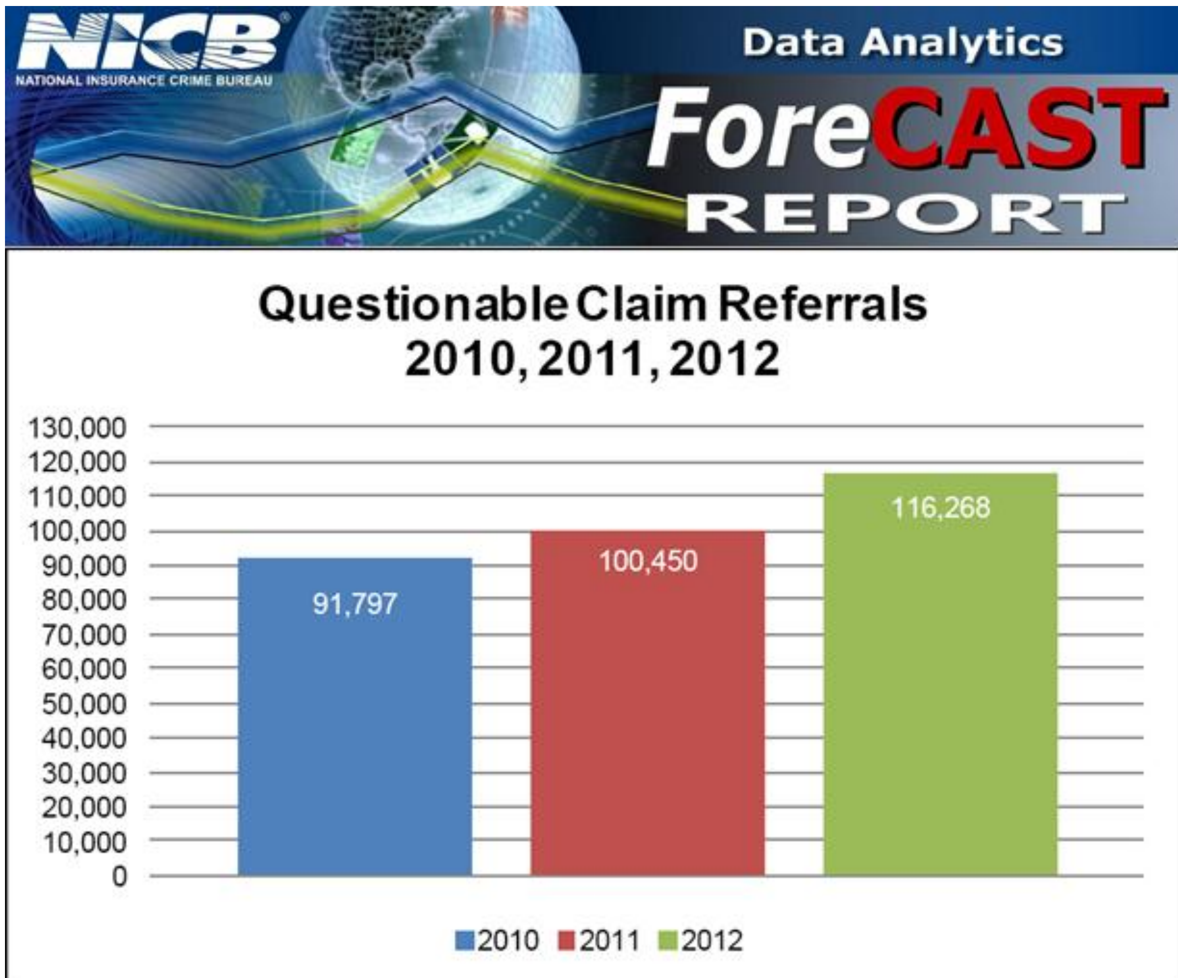
In handling of claims by a named insured, evidence the property is in any phase of a foreclosure proceeding also should give cause for concern to insurance carriers. It is important for insurers to remember a lienholder named on the policy is an insured under that contract, and is entitled to notice of any action which may affect their insurable interest. We have handled far too many claims where an insurance carrier denied coverage for a loss to the named insured, but failed to provide a copy of the notification to any additional insured, loss payees or lienholders. It is normally always best for an insurance carrier denying coverage to notify any potential parties who may have a valid claim under the policy of the coverage decision.

A. "Forced Place" Policies

In recent years, with the decline in the national and Ohio economies, there have also been a greater number of "forced place" policies on Ohio properties in foreclosure. While there may be some exceptions, in my legal career of a quarter century I have yet to see a single "forced place" insurer issue payment on any claim. Our investigations have normally shown these "insurance companies" are often subsidiaries of the actual lienholder themselves, and the extremely high premiums often charged for "forced place" policies are included in the "damages" being sought for foreclosure. When a loss occurs, however, there is always some reason why the "forced place" company does not owe coverage. It is extremely important in all matters associated with foreclosure for Ohio insurance carriers to know additional "damages" such as accrued interest, penalties, late fees and "forced place" policy coverage premiums are not recoverable as damages, and the insurance policy only covers the actual physical damage to the structure or, where appropriate, its contents.

B. Consider Lienholder Fraud As Well

As a final note, insurance companies should not overlook the potential for lienholder fraud. While it would be a wonderful concept to think every bank, mortgage company and lending institution is of the highest moral and ethical standards, there has been an extreme amount of mortgage fraud committed in America in the past decades. Many analysts believe this fraud has substantially contributed to today's foreclosure crisis. Insurers who fail to investigate and consider the potential for mortgage fraud do so at their own risk and peril. As this chart from The National Insurance Crime Bureau demonstrates, the number of claim referrals for potential fraud continues to increase annually throughout the United States in general and Ohio in specific.



From 2011 to 2012, the Property category had the highest percentage increase.

Insurers who are involved in claims concerning foreclosed property should carefully review these claims as they would any other for the potential of insurance fraud being present. Thorough and complete investigations should be done, including requiring lienholders to sign authorizations, making certain insurers' rights against the lienholder are fully reserved as would be done with any named insured. Provisions should also be invoked to produce requested information and documentation, and submit to Examination Under Oath testimony where appropriate.

VII. Conclusion

While it is true the number of foreclosures in our state is slowly beginning to decline, this is an issue which will remain present in Ohio insurance law for many years to come. Insurers have already lost tens of millions of dollars in claims which perhaps should have been investigated further, or where potentially coverage was not due and owing in any regard. It is important to remember we do always owe any insured, whether a named insured, loss payee, additional insured or lienholder, the full benefits they are entitled to under the insurance contract. Equally, however, we must also remember it is innocent policyholders not making claims who pay for losses through higher premiums. It is incumbent upon all of us in the insurance industry to know what the specific rights, duties and responsibilities are of lienholders and to make certain payment is made in strict accordance with all policy terms and provisions as well as Ohio law. We owe this to our companies, as well as to the citizens of this state who put their insurance trust and needs into our hands.