

LITIGATION

Update

NEWS FOR THE CLIENTS AND FRIENDS OF BASS, BERRY & SIMS PLC

Tennessee Court of Appeals Cases re Notification of Foreclosure

March 17, 2008

With the increase in the number of foreclosures in Tennessee, a recent Tennessee Court of Appeals decision is cause for concern by lenders.

In *U.S. Bank, N.A. v. Tennessee Farmers Mutual Insurance Co.*, 2007 Tenn. App. LEXIS 788 (Dec. 21, 2007), the Tennessee Court of Appeals found that the commencement of foreclosure proceedings by a lender amounts to an increase in hazard under a standard mortgage clause in fire and extended coverage insurance policies, and failure of U.S. Bank as mortgagee to notify the insurer of the commencement of foreclosure proceedings voided coverage under the policy when the house was destroyed by a fire.

Tennessee Farmers denied U.S. Bank's claim for loss resulting from a fire destroying the insured home based on a policy provision requiring the mortgagee to notify Tennessee Farmers of any circumstances increasing the insurer's risk. The insurance policy in place at the time of the fire provided that the bank was required to notify the insurer "of any change of ownership or occupancy or any *increase in hazard* of which the mortgagee has knowledge." In addition, the court found that Section 56-7-804 of the Tennessee Code required the bank to notify the insurer of the commencement of foreclosure proceedings. In the opinion of the Court, because U.S. Bank had commenced foreclosure, an "increase in hazard" had occurred, and its failure to notify Tennessee Farmers prevented U.S. Bank from recovery under the policy and the statute.

The court reasoned that the commencement of foreclosure proceedings increases the risk of a fire loss, because it gives homeowners threatened with losing their homes the incentive to destroy the property in order to collect insurance proceeds which can then be applied to their delinquent mortgages. When U.S. Bank notified the homeowner that it was beginning foreclosure proceedings, it had a duty under the policy and the statute to notify Tennessee Farmers as well, the court reasoned.

While we understand U.S. Bank will request review of this decision by the Tennessee Supreme Court on a variety of grounds, lenders should consider notifying insurers of the commencement of foreclosure in order to avoid possible loss of coverage under a fire and extended coverage policy, but lenders should be mindful of the obligation to preserve customer information that is considered confidential under the Tennessee Financial Records Privacy Act.

The materials contained herein have been abridged from the statutory sources and should not be construed or relied upon for legal advice. Readers are urged to consult legal counsel concerning particular situations and specific legal questions.

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