

## Answers to Assignment 3 Questions

NOTE: These answers are provided to give students a basic understanding of acceptable types of responses. They often are not the only valid answers and are not intended to provide an exhaustive response to the questions.

### Educational Objective 1

- 1-1. Insurance contracts involve an exchange of unequal amounts because often there are few or no losses, and the premium paid by the insured for a particular policy is more than the amount paid by the insurer to, or on behalf of, the insured. If a large loss occurs, however, the insurer's claim payment might be much more than the premium paid by the insured. The possibility that the insurer's obligation may be much greater than the insured's makes the insurance transaction a fair trade.
- 1-2. Courts have held that an insurer must prove these two things:
  - The failure to disclose information was intentional, which is often difficult to establish.
  - The information withheld was a material fact.
- 1-3. In normal usage, a misrepresentation is a false statement. As used in insurance, a misrepresentation is a false statement of a material fact on which the insurer relies.
- 1-4. The identities of the persons or organizations insured are extremely relevant to the insurer, which has the right to select those applicants with whom it is willing to enter into contractual agreements. After an insurance policy is in effect, an insured may not freely transfer, or assign, the policy to some other party.

### Educational Objective 2

- 2-1. The insurance application, signed by the applicant and sent to the insurer through the producer, is the offer. The insurance policy issued later is the acceptance.
- 2-2. If the policy issued does not conform to the application—the initial offer—the policy is a counter-offer requiring the applicant's specific acceptance.
- 2-3. Courts apply the rationale in this situation that insurance is a business affected with a public interest. Because insurers have generally solicited these offers, and because applicants frequently pay premiums in advance, the insurer must act promptly in accepting or rejecting the offer.
- 2-4. A court will consider these facts regarding unreasonable delay:
  - The distance of the insurer's office from the agent's office at which the applicant submitted the application
  - Special difficulties in underwriting the risk
  - The insurer's seasonal or other workload problems
  - The type of coverage involved



- 2-5. Oral agreements often give rise to lawsuits, usually involving the insurer's word against the insured's, with a court making final judgment. An insured who does not have a written policy may be unable to recall an oral conversation with sufficient accuracy to persuade a jury of its content.
- 2-6. Delivery of a contract is rarely in dispute for property-casualty policies because of the wide use of preliminary oral agreements and written binders, which give rise to effective dates of coverage that seldom involve the question of policy delivery.

### Educational Objective 3

- 3-1. In jurisdictions that have not adopted direct-action statutes, the purpose of liability insurance is to indemnify only insureds for their losses in paying damages to the victims. In these situations, the third-party victims cannot sue under the liability policies until courts have ordered judgments against the insureds. If an insurer denies claim payments after a judgment, then a third party can sue an insurer directly.
- 3-2. A real estate buyer obtains an equitable interest in the property as soon as both parties sign the agreement of sale. The real estate belongs to the buyer, subject to the payment of the purchase price, under the doctrine of equitable conversion. One result of this equitable ownership is that the buyer bears the risk of loss and would therefore require an insurance policy to protect his or her interest in the property.
- 3-3. If the mortgage does not specify who will obtain insurance, one of three situations can occur:
  - The mortgagor can obtain separate insurance on the property, solely for the mortgagor's benefit.
  - The mortgagee can obtain separate insurance on the property. If so, money the insurer pays in the event of loss does not accrue to the mortgagor's benefit and therefore is not payable to the mortgagor.
  - The mortgagor can obtain insurance for the mortgagee's benefit by either assigning the policy to the mortgagee or including on the policy a standard mortgage clause making any proceeds under the policy payable to the mortgagee "as the mortgagee's interest may appear."
- 3-4. Insurance protection to cover a lessee's liability for fire damage to insured property can now take several forms:
  - The insurer waives its subrogation rights against the lessee by endorsement to the lessor's fire policy.
  - A lease provision placing "all-risks" loss on the lessor is included on the policy.
  - The lessee is included as an additional insured on the lessor's policy.
  - The lessee purchases an insurance policy protecting against liability for causing damage to the lessor's property.
  - The lessee purchases a separate fire policy covering the leased premises.

### Educational Objective 4

- 4-1. False representation, or misrepresentation, may make an insurance contract voidable.



- 4-2. The elements required to establish false representation are:
- A statement is made that is false or misleading.
  - The statement relates to a material fact.
  - The insurer relies on the false or misleading statement in issuing the policy.
- 4-3. The rule under most contribute-to-loss statutes is that, regardless of materiality, a misrepresentation does not allow an insurer to avoid the contract if, from its very nature, it could not contribute to the loss. Increase-of-risk statutes can set either an objective or a subjective standard for determining materiality.
- 4-4. These two requirements must be present for a promise to be a warranty:
- The parties must have clearly and unmistakably intended it to be a warranty.
  - The statement must form a part of the contract itself.
- 4-5. An affirmative warranty states that specific facts exist at the time the contract forms. A continuing, or promissory, warranty states that the parties will do certain things or that certain conditions will continue to exist during the policy term.
- 4-6. When courts interpret policies as severable, if one policy provision is invalid, it need not invalidate the entire policy but can be severed, or separated, from other provisions. Therefore, non-compliance with a warranty concerning one type of covered property will not defeat coverage for another type of property to which the warranty does not relate.

## Educational Objective 5

- 5-1. For waiver to occur, an insurance policy must exist. A statement made before an insurance contract comes into existence is not a waiver of a known right, but an attempted waiver of a future right.
- 5-2. The parol evidence rule prohibits the introduction into evidence at trial of any oral agreements made before, or contemporaneous with, the formation of a written contract. The law assumes that final written insurance policies contain all waiver agreements that have arisen from words or acts before or during the writing of the policy.
- 5-3. Estoppel arises in insurance law from this sequence of events:
- False representation of a material fact
  - Reasonable reliance on the representation
  - Resulting injury or detriment to the insured
- 5-4. Waiver differs from estoppel in these ways:
- Waiver is contractual and rests upon agreement between parties. Estoppel is equitable and arises from false representation.
  - Waiver gives effect to the waiving party's intention. Estoppel defeats the inequitable intent of the estopped party.
  - The parol evidence rule applies to waiver but not to estoppel.



## Educational Objective 6

- 6-1. Insurers use nonwaiver agreements and reservation of rights letters to inform an insured that the insurer's activities regarding a loss are not the relinquishment of its right to stand on policy provisions. An insurer might be able to establish that it is not liable under the policy. The insurer can continue to investigate and evaluate the loss on its merits, an activity beneficial to both the insurer's and insured's interests. Simultaneously, the insurer can determine whether the insured has violated policy terms and whether the insurer will accept liability under the policy.
- 6-2. These practical difficulties may arise in the attempt to secure the insured's consent and signature on a nonwaiver agreement:
  - The insured might refuse to sign the agreement, even after the claim representative has clearly explained its significance. This refusal can delay the investigation of the loss.
  - The insured could challenge the nonwaiver agreement if the claim representative has not explained the importance of the agreement fully and fairly. The lack of adequate explanation can lead an insured to claim lack of contractual intent, misunderstanding, duress, or other defenses that can jeopardize the agreement's validity.
- 6-3. A reservation of rights letter serves the same purpose as a nonwaiver agreement but is in letter form, and it is a unilateral document, meaning it does not require the insured to sign or agree to the contents of the letter.

