

Understanding the Insurance Contract: Rules for Reading ANY Insurance Policy

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Session Agenda

- The Law of Insurance Contracts
- The Rules for Interpreting an Insurance Policy



The Law of Insurance Contracts

Why Insurance Contracts are Necessary

Each party has its own view and purpose in the insurance transaction!



How the Insured sees his house!

How the Agent describes the house!



How the Underwriter imagines the house!

Insurance is Subject to the Laws of Contract

- “Contract” – A formal agreement between two or more parties intent on accomplishing a specific task, purpose or goal:
 - Can encompass the performance of an act or acts or an agreement to refrain from a particular deed
 - Two types of contracts:
 - Express
 - Implied
 - Implied-in-fact
 - Implied-in-law

When there is an “express” contract, the existence of the contract creates a duty.

When there is an “implied” contract, the performance of a “duty” or undertaking of an action creates a contract.

Insurance is Subject to the Laws of Contract

- Insurance is the transfer of risk (***of financial loss***) from the insured to an insurance carrier – **by contract**
- Involves payment of a premium in exchange for a promise
- Without a contract, enforcing the promise would be difficult
- Although subject to the general law of contracts, insurance contracts require special consideration and treatment due to their unique nature

The General Law of **ALL** Contracts

- Offer and Acceptance
- Consideration
- Legal Object
- Competent Parties
- Legal Form

Unique Characteristics of Insurance Contracts

- Indemnity Contract
- Personal Contract
- Unilateral Contract
- Conditional Contract
- Contract of Adhesion
- Aleatory Contract
- Contract of Utmost Good Faith

Indemnity Contract

- “Indemnity” is to put the insured or injured party back in the same financial condition that existed prior to the loss or would have existed had no loss occurred
- Insurance policy accomplishes this through:
 - In Property: requiring insurable interest at the time of the loss. Insurable interest can arise out of ownership, bailment, loan/mortgage or contract.
 - Cannot put the insured in a better position than existed prior to the loss
 - Actual Cash Value
 - vs
 - Replacement Cost
 - “Other Insurance” provisions
 - Pro-rata split – either proportional (by limits) or equal shares up to exhaustion of limits
 - Excess of loss – first policy pays until limits are exhausted, then second responds
 - Subrogation/Contribution – the insurance carrier’s right to collect from the at-fault party

Personal Contract

- The insurance carrier underwrites the risk presented by the particular insured
- Insurance is a contract between two “persons”
- Two “types” of “persons”
 - Natural persons
 - Legal persons
- This requires:
 - Named insured to be correct
 - Non-transference of insurance policies

Unilateral Contract

- “Uni” means “one way”
- The **promise** of one party (the insurer) is given in exchange for the **act** of another party (the insured)
 - The insured pays the premium and the insurance carrier promises to pay if a covered loss occurs (see Aleatory)
 - If nothing happens, nothing is required of the insurance carrier (“I’ve been paying for this insurance for years and never had a loss.”)

Most non-insurance contracts are bilateral

Conditional Contract

Before the insurance contract is activated, certain conditions must be met:

- A **condition precedent** must be fulfilled to activate the promises in the contract:
 - Pay the premium
 - Not violate policy provisions (arson, intentional injury, etc.)
- **Conditions subsequent** are found in the “Duties After a Loss”

Contract of Adhesion

- Involves an unequal bargaining positions:
 - The insurance carrier
 - The insured

Between the two, who has more power regarding policy language?
- The insurance contract is offered to the insured on an “as is,” “take it or leave it” basis (They are STUCK with it)
- Explains why Courts:
 - Interpret coverage broadly
 - Apply exclusions narrowly
 - Find in favor of the insured when Ambiguity exist (Latin: ***Contra Proferentem***)

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- What about “manuscripted” forms or endorsements?

Aleatory Contract

- The performance of one or both parties is contingent on the occurrence of an event that may **never** materialize

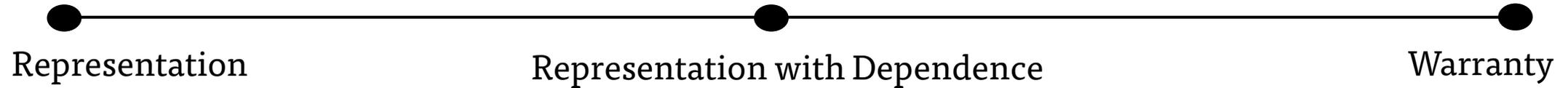
A Covered Loss

Contract of Utmost Good Faith

- **Uberrima Fidei**
- Both parties to the insurance contract almost totally rely on the honesty of the other party

Contract of Utmost Good Faith

- Representations versus Warranties



- Misrepresentation and Concealment
 - Misrepresentation: A lie!
 - Concealment: The sin of omission!
- Material Facts
- Void

The Insurance Contract and “Reasonable Expectation”

- Insurance Contracts are:
 - Subject to statutes related to contracts
 - Subject to the Statute of Frauds
 - Subject to common law and the concept of *stare decisis* (precedent)
- Concept of “Adhesion” added that any ambiguity is found in favor of the insured
- Add the concept of “**Reasonable Expectation**” which holds that the contract is to be interpreted in the same way a reasonable buyer (no law degree or insurance training) would interpret it
 - More than one **reasonable** interpretation
 - **Law of Agency** plays a part

The Insurance Contract and “Reasonable Expectation”

- When does “Reasonable Expectation” Apply
 - When terms are not defined within the policy
 - When the plain meaning is not readily apparent in the context of the whole
 - *“Text without context is a pretext for a prooftext”*
 - Eiusdem Generis – based on context
 - Noscitur A Sociis – known by its accompanying words

Neither the carrier nor the insured can take and apply words, phrases or sentences out of context!

Construction of the Insurance Contract

- Declarations – Everything about the insured, the insurer, limits, forms and endorsements
- Insuring Agreement – The broadest the coverage will ever be
- Conditions – What has to be done
- Exclusions – What's not covered by the policy
- **Endorsements** – Alters the wording and response of the contract

The Rules of Reading Any Insurance Policy

- Determine who qualifies as **the** and **an** “Insured”
- **Annotate** the policy to indicate wording changed by endorsements
- Compare forms and endorsements to those listed on the declarations page
- Read the Insuring Agreement first
- Read Exclusions after reading the Insuring Agreement
- Read the exceptions to the exclusions
- Immediately read sections referenced in the form and **endorsements** attached to the form.
- Pay attention to conjunctions
- Pay attention to key words and phrases
- Understand specifically defined terms
- Confirm all policy conditions have been met
- Confirm adequate coverage limits

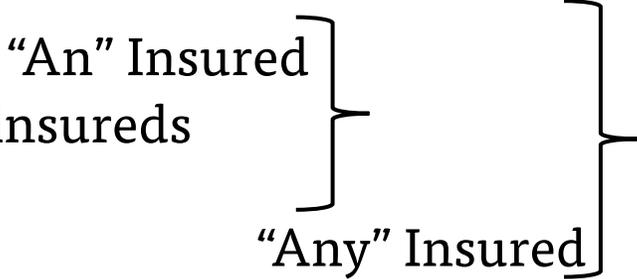
Who Qualifies as an “Insured” - Key Issues

1. Status as an “Insured” must exist before any question of coverage can be tackled!
2. In Property Coverage, the named insured must have “Insurable Interest.”
3. Improperly naming/listing **the** insured can result in no coverage.

Who Qualifies as **the** and **an** “Insured”

Up to four *levels* of “Insured” (mostly liability coverage)

- Named insured (“The” insured)
- Extended (Additionally Listed based on entity type) insureds
- Automatic insureds
- Additional insureds (by endorsement)



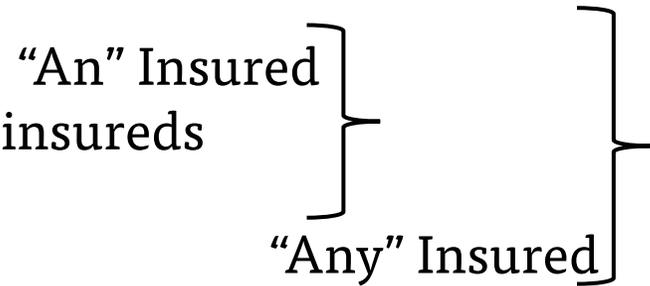
Property is based on “Insurable Interest”: is the person/entity with “insurable interest” protected?

Ownership Bailment Contract Mortgage/Loan

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Ownership	Bailment	Contract	Mortgage/Loan
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Just because one person or entity does not qualify as an insured does not mean that another party doesn’t – vicarious liability

If the person or entity suffering or causing the loss, injury or damage does not qualify as the or an insured at some level, there is no need to go any further - there is no coverage.

Correctly Naming Insureds

Entity Type Differences:

1. Corporation:
2. Professional Association:
3. LLC/LLP:
4. Partnerships:
5. Sole Proprietors:
6. Joint Ventures:
7. Associations:
8. Trust:

Read the Insuring First

- This is the broadest the coverage is ever going to be
- If the loss is not considered within the insuring agreement, no need to go any further
- There are generally limitations found in the insuring agreement

Commercial General Liability – Coverage Part A Insuring Agreement

We will pay those sums that **the insured** becomes legally obligated to pay as damages because of "bodily injury" or "property damage" to which this insurance applies. We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" seeking damages for "bodily injury" or "property damage" to which this insurance does not apply...

Commercial Property Insuring Agreement

We will pay for direct physical loss of or damage to Covered Property at the premises described in the Declarations caused by or resulting from any Covered Cause of Loss.

Read the Exclusions

- Special cause of loss property forms and most liability coverage creates coverage using exclusions. If the loss or incident is **NOT** excluded, it's covered
- Named peril property forms, the CGL Part "B" and other liability forms spell out what **IS** covered – so read the coverages first, then the exclusions

Read the Exceptions to the Exclusions

- It's easier for the carrier to give coverage back by exception than to try to use a long list of exclusions
- Allows the insurer to control the breadth and sometimes the limits of coverage provided
- Used in property and liability forms

Understand Why Exclusions Exist

Three categories of exclusions

- Excluded “perils”
- Excluded “hazards”
- Excluded “property”

Understand Why Exclusions Exist

Six reasons for exclusions:

1. The peril or property is better covered in another policy
2. The loss or damage is catastrophic in nature
3. The loss or damage is not accidental or unforeseen
4. The insurance carrier is willing to provide coverage; they just want more information and more premium
5. The insurance carrier wants to control the amount of coverage granted
6. The loss is the result of “speculative” or business risk

Pay Attention to Conjunctions

- “**And**” is inclusive meaning that all conditions have to be met
- “**Or**” is exclusive meaning that only one of the requirements must apply



More Conjunctions and Conjunctive Phrases

- But...
- Yet (not yet...)
- Even if...
- Provided that...

Pay Attention to Key Words and Phrases

- Quantifying terms
- Conditional terms
- Requisite terms
- Sequential terms

Key Words and Phrases

- "Not"
- "Greater than..."
- "Lesser than..."
- "Greater of..."
- "Lesser of..."
- "No more than"
- "The most..."
- "All"
- "Any"
- "Unless,"
- "Except"
- "Only if..."
- "Subject to..."
- "However"
- "Includes"
- "Must"
- "Regardless"
- "First"

Confirm Policy Conditions Have Been Met

- Failure to meet policy conditions can produce negative results like the denial of coverage
- Two types of conditions:
 - Conditions Precedent
 - Conditions Subsequent



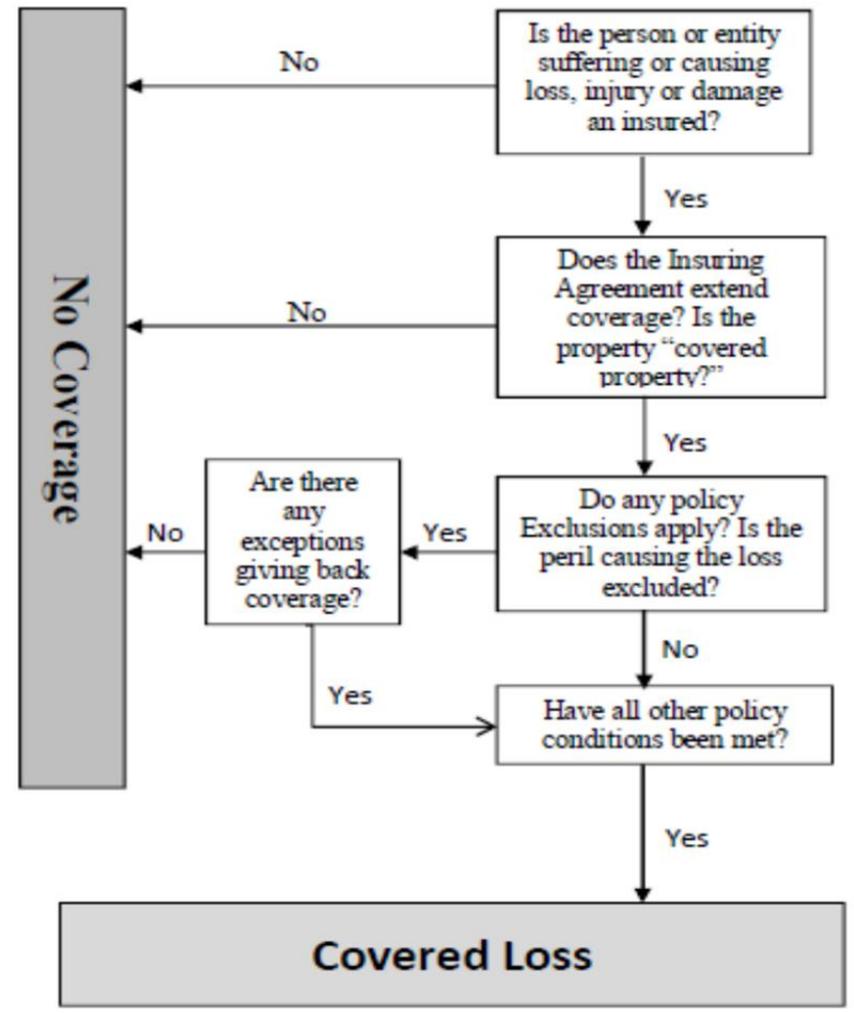
Conditions Precedent

- Premium has been paid
- No policy provisions violated
- Utmost Good Faith
- A covered loss occurs

Conditions Subsequent

- Duties in the Event of Loss or Damage
- Recovered Property
- Vacancy
- Coinsurance
- Duties in the Event of Occurrence, Offense, Claim or Suit
- Legal Action Against Us

Flowchart



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