
CHAPTER I

What Is Insurance?

Insurance is a contract that requires an offer to provide insurance to a person or entity, acceptance of the offer, and payment of consideration called a premium. Insurance is defined by California Insurance Code as “a contract whereby one undertakes to indemnify another against loss, damage, or liability arising from a contingent or unknown event.”¹

As such it is a special type of contract because it is limited to provide protection only from a contingent or unknown event. Any loss to be covered must be fortuitous, accidental, contingent or unknown. An intentional act should never be the subject of insurance.

Insurance, otherwise, is just like any other contract.

What Is a Contract?

A contract is a legally binding, valid agreement between two parties. The law considers a contract to be valid if the agreement contains all of the following elements:

- offer and acceptance;
- an intention between the parties to create binding relations;
- consideration to be paid for the promise made;
- legal capacity of the parties to act;
- genuine consent of the parties; and
- legality of the agreement.

An agreement that lacks one or more of these elements is not a valid contract.

Insurable Interest Must Exist to Acquire Insurance

The applicant must have an insurable interest in the property whose risk of loss is sought to be insured.

An insurable interest is any interest in property where the insured might be damaged if the property is lost. For example, the owner of a

1. CAL. INS. CODE § 22.

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warehouse has an insurable interest in the structure because his ownership interest would be damaged or destroyed if the structure is lost. On the other hand, the owner's mother-in-law has no interest in the property and could not acquire insurance in her name.

Consider the situation where Mrs. Jones is allowed to live rent free in a home owned by her children. Mrs. Jones purchases, in her name alone, a policy of homeowners insurance, insuring her against the risks of loss to the structure and its contents. If a fire destroys the house, Mrs. Jones can recover because her interest in the house is an "insurable interest." This means she has an interest in the property sufficient that she will suffer a loss if the property is damaged or destroyed. Mrs. Jones's children, the owners of the home, also have an insurable interest in the home, but are not insured under Mrs. Jones's policy and may not recover any proceeds from the policy.

In California, as in most states, in common parlance, we speak of a house as being insured, but, strictly speaking, it is not the house but the interest of the owner therein that is insured. Whether that interest is founded upon a legal title, an equitable title, a lien, or such other lawful interest as will produce a direct and certain pecuniary loss to the insured by its destruction, the person insured has an insurable interest in the property.

Only a person who is both an insured and who has an insurable interest may obtain indemnity from a policy of first party property insurance. In *Russell v. Williams*, the California Supreme Court stated the rule:

It is a principle of long standing that a policy of fire insurance does not insure the property covered thereby, but is a personal contract indemnifying the insured against loss resulting from the destruction of or damage to his interest in that property.²

The property is not insured against destruction. The insured is guaranteed against loss, to the extent of his insurable interest, not exceeding the amount stipulated in the insurance contract. As the betterments and improvements installed in the building passed to the owner at the expiration of the lease, in part consideration for the rent, the tenant could not sell them, or remove them, or recover their value. It had no other insurable interest than the right to use them until the expiration of the lease. The use interest is insurable but is not the same as an ownership interest.³

2. *Russell v. Williams*, 58 Cal. 2d 487, 374 P.2d 827, 24 Cal. Rptr. 859 (Oct. 4, 1962).

3. *Lighting Fixture Supply Co., Inc., v. Fidelity Union Fire Ins. Co.*, Circuit Court of Appeals, Fifth Circuit, 55 F.2d 110 (1932); *Grange Mut. Cas. Co., v. Central Trust Company, N.A.*, 774 S.W.2d 838 (1989).

In *Hulme v. Springfield Life Insurance Co.*,⁴ the plaintiff was the beneficiary of a life insurance policy of his business associate. The court held that the plaintiff had an insurable interest in his business associate's life because of the close business (economic) association between the two men, which involved extensive sharing of business assets. Since both parties substantially depended on each other, an insurable interest existed.

To establish the existence of an insurable interest, the interest must be real and supported by evidence, or the right to recover will fail.

Property owners hold real estate in trust in order to avoid probate costs, estate taxes, and legal challenges to a will. In *Burns v. California Fair Plan*,⁵ the Court of Appeal held that multiple insureds cannot recover more than the value of the property destroyed on a fire insurance claim resulting from a single occurrence. In reaching that conclusion, the *Burns* court expanded on key insurance concepts including "insurable interest," the purpose of property insurance and "other insurance."

California Insurance Code defines insurable interest as "[e]very interest in property, or any relation thereto, or liability in respect thereof, of such a nature that a contemplated peril might directly damnify the insured, is an insurable interest."⁶

A policy does not insure property itself but instead insures the policyholder's "pecuniary interest" in preserving the property from destruction. Refusing to allow the double recovery, the *Burns* court stated:

Our Supreme Court long ago recognized the nature of insurance does not provide for recovery in excess of the value of the property destroyed where there is but one loss.

- (i) As a contract of indemnity, not a source of potential profit, a policy's "sole purpose is to guarantee against loss or damage." Burns' "life" interest was limited by her life span, and the trust's remainder interest depended on how long Burns survived. So both could not recover the full value of the loss.⁷

The court rested its decision that the two policies should share in the loss in a pro rata fashion on the "other insurance" clause of the standard California Fire Insurance policy. It found that "other insurance" exists when several insurers issue policies covering interests in the same property. Typically, this arises when policies are purchased separately

4. *Hulme v. Springfield Life Ins. Co.*, 565 P.2d 666 (1977).

5. *Burns v. Cal. Fair Plan*, 61 Cal. Rptr. 3d 809, 152 Cal. App. 4th 646 (2007).

6. CAL. INS. CODE § 281 .

7. *Burns v. Cal. Fair Plan*, 61 Cal. Rptr. 3d 809, 152 Cal. App. 4th 646 (2007).

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by seller and buyer, lessor and lessee, mortgagee and mortgagor, joint owners, or, life tenant and remainderman. In such an instance, the specific terms of the policies' respective "other insurance" clauses dictate how the insurers must pay on a loss.

Every first party property policy contains a limitation not specified on the declarations page, for example, that an insured should recover only up to the amount of the insured's insurable interest in the property. To allow any more would cause a profit, turn insurance from indemnity to a wager, which would greatly tend to the destruction of like property under like circumstances, and open the door and tempt men to enter therein for fraudulent purposes.

Permitting a double recovery would encourage some property owners to damage their own properties intentionally and make claims for more than their insurable interest. In order to indemnify and not enrich, a property loss involving several insureds and "other insurance" warrants a total payment no greater than the insureds' combined insurable interests. It cannot support payment of an amount in excess of the loss suffered.

An insurable interest may be entirely disconnected from any title, lien, or possession, and may derive solely from possession, enjoyment, or profits of the property, as well as other certain benefits growing out of or dependent upon it.

Under Florida law, property insurance contracts are enforceable only where the insured has an insurable interest in the covered property at the time of the loss.⁸

An insured does not need to own property to have an insurable interest. Instead, Florida law defines an insurable interest as an "actual, lawful, and substantial economic interest" in keeping the property "free from loss, destruction, or pecuniary damage or impairment."⁹

How Does a Person Obtain an Offer of Insurance?

When a person or a business decides he, she, or it needs to obtain insurance to protect against the risk of loss of real or personal property they must understand what insurance is and how it is obtained.

To obtain an offer of insurance the prospective insured needs to make contact with the insurer.

Contact is made by use of an insurance agent, an insurance broker, or directly to a special kind of insurer known as a direct writer. Each will start the process of obtaining insurance by requiring that the prospective insured submit an application for insurance. The application is designed to provide potential insurers with sufficient information

8. FLA. STAT. § 627.405(1) (2018).

9. *Id.* § 627.405(2).

to allow an insurer to understand the risks of loss that are faced by the prospective insured.

The application—whether presented through an insurance agent, insurance broker, or directly to a direct writing insurer—is a request that an insurer make an offer for insurance. It is a means of introducing the prospective insured to insurers from whom it seeks insurance.

Applications vary depending on the type of insurance sought, the insurance agent or broker, the insurer, or the person or entity that is seeking insurance. Most insurers that provide commercial first party property insurance—the subject of this book—use a standard form of application created by the Association for Cooperative Operations Research and Development (ACORD). ACORD is a nonprofit organization that produces for the insurance industry, applications and policy wordings for the use of insurers.

Established in 1970 as a nonprofit organization, ACORD was formed by insurance carriers and agents focused on building efficiencies in the U.S. property casualty insurance market. Originally termed the Agent Company Operations Research and Development Organization, its initial goal was to standardize the many proprietary forms being used by insurers for new business and claims submission. In the late 1970s, ACORD began developing electronic standards to complement its form standards.

The basic commercial property ACORD application that is filled out by most commercial property owners seeking insurance against the risk of loss of real and personal property asks some of the following information:

- The name of the applicant
- The effective and expiration date of the policy sought
- The subject or subjects of the insurance requested
 - The description of a structure
 - The description of the personal property in the structure
 - The description of the equipment in the structure or serving the structure
 - Any other property the risk of loss of which the applicant seeks protection
- The value of the property
- Whether coinsurance is to be included
- The causes of loss the applicant seeks to be covered
 - Named perils like fire, lightning, windstorm, or hail
 - Direct risks of physical loss not specifically excluded that was traditionally called “all risk” of physical loss coverage
- Whether inflation guard coverage is required
- The deductible sought by the applicant
- Forms and conditions required
- Limits of liability sought

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- Construction type
- Distance to a fire hydrant or fire station
- Protection class of the structure
- Number of stories
- Number of basements
- Year built
- Total square footage of the structure
- All building improvements
- Whether the structure has been upgraded to meet current codes
- Roof type
- Plumbing, heating, wiring, roofing ages and updates
- Whether there is a heating boiler on the premises
- Distances to exposures to other structures on the right, left, front, or rear and the distance from each
- Security like burglar alarms, fire alarms, sprinklers, chemical fire suppression systems, and the manufacturer of the systems
- All interests in the property whether by mortgage, lien, or multiple owners
- The nature of the applicant's business
- Description of primary operations
- Whether a safety program is in operation
- Existence of any other insurance with the company
- Whether any policy or coverage for the applicant was declined, cancelled, or non-renewed during the prior three years for any premises or operations
- Any past losses or claims
- Whether, in the last five years, the applicant was indicted for or convicted of any degree of the crime of fraud, bribery, arson, or any other arson-related crime in connection with the property or any other property
- Any uncorrected fire and/or safety code violations
- Whether applicant had a foreclosure, repossession, bankruptcy, or filed for bankruptcy during the last five years
- Whether the applicant had a judgment or lien during the last five years
- Whether the business has been placed in a trust
- Whether the applicant has any other business ventures for which coverage is not requested
- A detailed history of prior insurance
- A detailed loss history showing the date, type of insurance, type of claim, date of claim, amount paid, amount reserved, whether there is a subrogation potential, and whether the claim is still open

In addition, the application form contains the following warning to every prospective insured:

Any person who knowingly and with intent to defraud any insurance company or any other person files an application for insurance or statement of claim containing any materially false information or conceals for the purpose of misleading information concerning any fact material thereto, commits a fraudulent insurance act, which is a crime and subjects the person to criminal and civil penalties.

The insurer, to enable it to make a reasoned decision on which risks it is willing to take, uses the application to know everything possible about the applicant and the risks of loss the applicant is asking the insurer to take. From this information the insurer, by its underwriter, will either make an offer—called a proposal for insurance—or not. The offer will state the type and amount of insurance the insurer is willing to issue and the premium it requires.

The underwriter is the risk taker, the decision maker, the person who either agrees to insure or refuses to insure. The title “underwriter” came from the early history of insurance when policies were written on a blackboard in Edward Lloyd’s coffee shop in London where the insurer signed the wording at the bottom. That is, they wrote their names under the policy.

As the warning at the end of the application should make clear, an application for insurance is a very important document that must be accurate and provide totally truthful responses to each of the detailed questions; depending on the state, a false answer can result in a criminal prosecution of the applicant. In those states where there is no criminal exposure, a false response to any inquiry on the application can result in the policy being cancelled, declared void, or rescinded from its inception. For that reason, most commercial applicants need, and should use, the assistance of a professional insurance agent, broker, or risk manager.

The Use of an Insurance Agent

An insurance agent is licensed by the state or states in which he, she, or it does business. The property/casualty insurance agent is a person authorized by and on behalf of an insurer to transact all classes of insurance other than life, disability, or health insurance, on behalf of an admitted insurance company. The agent will charge the applicant nothing directly but will rely on the insurer to pay him a commission—anywhere from 5 to 15 percent of the premium.

The person or entity seeking insurance will contact the insurance agent who will assist in preparing the application and obtaining insurance from insurers who have appointed the insurance agent and provided the agent authority to effect insurance on its behalf. For some

risks of loss the agent is only authorized by the insurer to exclusively present potential risks to an insurer with whom it has been appointed to obtain insurance, for agreement by the insurer.

To do the agent's job properly he or she will meet with the applicant to determine the type of insurance required and the people who have an interest in the property the risk of loss of which is to be the subject of the insurance. The agent may, and often does, visit the property that is to be the subject of the insurance.

The agent will then start the work of completing the application with the assistance of the applicant. He or she will complete the form—usually by computer filling in an ACORD application in an Adobe Acrobat .pdf form that allows entry of information. The prudent agent will assist the insured in the obligation to answer all of the questions posed by the application form but will limit responses to facts related by the prospective insured.

When completed, the experienced agent will require that the applicant read the full application, report that the application accurately represents the facts and responds accurately to the inquiries made by the application, and then have the prospective insured sign and date the application.

Often, if the applicant has difficulty with English or a limited ability to read, the agent will read aloud every question on the application and then ask the applicant to acknowledge the accuracy of the questions on the application and to sign the application attesting to the accuracy of the information and that the applicant has been warned about the hazards of false answers.

If the risk is one within the authority provided the agent by the insurer a policy can be agreed to immediately. However, with regard to most commercial risks the agent will present the application to insurers with whom the agent has an appointment with specific attention to the insurer the agent believes will make an offer to accept the risk of loss specified in the application.

It usually takes a few days for the agent to obtain one or more proposals for insurance from the insurers to whom he or she has submitted the application. When a proposal or offer of insurance is received from one or more insurers the agent will submit those proposals to the applicant to determine which, if any, the applicant is willing to accept, explaining the difference in the proposals with regard to coverages provided and premium expected.

A proposal might begin with the following disclaimers and disclosures:

Confidentiality

The proposal will warn the applicant that the proposal contains proprietary confidential information concerning the agent and the agent's

customers. It may not be distributed or reproduced without the express prior written consent of the agent.

Insurance Terms and Conditions

The intent of the proposal is to provide a highlight of the coverage offered in an insurance program prepared by the agent and is not meant to be all inclusive. The agent makes clear that the applicant should read the actual policies for complete details, including terms, conditions, limitations, and exclusions.

Higher limits than those requested or proposed are available and will be quoted at the applicant's request. Property values used in the proposal were those provided by the applicant and should be carefully reviewed and/or appraised for adequacy.

Compensation

The agent is compensated for its services principally through commissions paid by insurance companies. The agent also shares in some profitability arrangements that are common in the insurance industry. The agent may also charge fees in cases where the insurance company does not pay commission or where the commissions paid do not cover the cost of the services provided or the special services it may perform to properly serve the insured.

Motor Vehicle Reports

The agent will request and review motor vehicle reports (MVRs) annually during the marketing process. On a midterm basis, the agent can run and review MVR for any employee or potential new hire. The agent makes itself available to advise as to the insurability of any particular driver employed by the applicant. However, the agent's response as to insurability in no way constitutes an opinion as to employability. The agent cannot release the actual MVR to the applicant, its client, without an MVR release form signed by the driver. In lieu of a signed driver release, the agent will accept a document from the client that states that their HR manual and/or employment application discloses that they will run motor vehicle reports at their discretion.

The Offers Made by the Proposal

The proposal will then list the offers made by the insurer or insurers, including:

- A schedule of those named as insured
- A schedule of the locations the risk of loss of which was to be insured
- A listing of equipment
- The basis for the rating of risk and how the insurer calculated the proposed premium