

5.3.6: Summary and Exercises

19.5 Summary and Exercises

Summary

Insurance is an inescapable cost of doing business in a modern economy and an important service for any individual with dependents or even a modest amount of property. Most readers of this book will someday purchase automobile, homeowner's, and life insurance, and many readers will deal with insurance in the course of a business career.

Most insurance questions are governed by contract law, since virtually all insurance is voluntary and entered into through written agreements. This means that the insured must pay careful attention to the wording of the policies to determine what is excluded from coverage and to ensure that he makes no warranties that he cannot keep and no misrepresentations or concealments that will void the contract. But beyond contract law, some insurance law principles—such as insurable interest and subrogation rights—are important to bear in mind. Defenses available to an insurance company may be based upon representation, concealment, or warranties, but an insurer that is overzealous in denying coverage may find itself subject to punitive damages.

Exercises

1. Martin and Williams, two business partners, agreed that each would insure his life for the benefit of the other. On his application for insurance, Martin stated that he had never had any heart trouble when in fact he had had a mild heart attack some years before. Martin's policy contained a two-year incontestable clause. Three years later, after the partnership had been dissolved but while the policy was still in force, Martin's car was struck by a car being negligently driven by Peters. Although Martin's injuries were superficial, he suffered a fatal heart attack immediately after the accident—an attack, it was established, that was caused by the excitement. The insurer has refused to pay the policy proceeds to Williams. Does the insurer have a valid defense based on Martin's misrepresentation? Explain.
2. In Exercise 1, was it necessary for Williams to have an insurable interest in Martin's life to recover under the policy? Why?
3. In Exercise 1, if Williams had taken out the policy rather than Martin, could the insurer defend the claim on the ground that at the time of Martin's death, Williams had no insurable interest? Why?
4. If Williams had no insurable interest, would the incontestable clause prevent the company from asserting this defense? Why?
5. If the insurer pays Williams's claim, may it recover from Peters? Why?
6. Skidmore Trucking Company decided to expand its operations into the warehousing field. After examining several available properties, it decided to purchase a carbarn for \$100,000 from a local bus company and to convert it into a warehouse. The standard contract for a real estate purchase was signed by the parties. The contract obligated Skidmore to pay the seller on an apportioned basis for the prepaid premiums on the existing fire insurance policy (\$100,000 extended coverage). The policy expired two years and one month from the closing date. At the closing, the seller duly assigned the fire insurance policy to Skidmore in return for the payment of the apportioned amount of the prepaid premiums, but Skidmore failed to notify the insurance company of the change in ownership. Skidmore took possession of the premises and, after extensive renovation, began to use the building as a warehouse. Soon afterward, one of Skidmore's employees negligently dropped a lighted cigarette into a trash basket and started a fire that totally destroyed the building. Was the assignment of the policy to Skidmore valid? Why?
7. In Exercise 6, assuming the assignment is valid, would the insurer be obligated to pay for the loss resulting from the employee's negligence? Why?

SELF-TEST QUESTIONS

1. The substitution of one person for another in pursuit of a legal claim is called a. assignment
b. coinsurance
c. subrogation
d. none of the above
2. Most insurance questions are covered by a. tort law
b. criminal law
c. constitutional law
d. contract law
3. Common defenses used by insurance companies include a. concealment
b. false representation

- c. breach of warranty
 - d. all of the above
4. A coinsurance clause a. requires the insured to be insured by more than one policy
- b. requires the insured to maintain insurance equal to a certain percentage of the property's value
 - c. allows another beneficiary to be substituted for the insured
 - d. is none of the above
5. Property insurance typically covers a. ordinary wear and tear
- b. damage due to theft
 - c. intentional losses
 - d. damage due to earthquakes

SELF-TEST AnswerS

- 1. c
- 2. d
- 3. d
- 4. b
- 5. b

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