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# **UNDERSTANDING PERSONAL LINES**

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## SECTION I : Personal Liability and the Legal System

### Criminal versus Civil Law

A person who commits an injury against society is guilty of criminal behavior while the person who violates the rights of another individual has engaged in tortious, or civil, misbehavior. Society punishes criminals with monetary fines and incarceration while **civil actions concentrate on awarding money damages to make the aggrieved party "whole" again.**

Personal liability concerns itself with civil, not criminal, misbehavior. The civil wrongdoer or tortfeasor can be held accountable for activities that are either intentional or unintentional. ***Purposefully injuring someone or committing a criminal act against another party is not within the concept of liability insurance coverage.*** Finally, personal liability insurance addresses the careless and negligent activities whose consequences can be the assignment of legal liability by the civil court system.

**An action can be both a tort and a crime but the tort that is also a crime will not be insurable.** In essence then it is the intent of the party that must be evaluated. If the action was malicious or premeditated with harm then the action will not be covered by personal liability insurance. The individual who intentionally harms others cannot be protected by insurance as most policies exclude deliberately caused injury and damage. The focus of this course in relation to liability coverage will center upon the unintentional torts arising from negligent actions.

### Determining Legal Liability

Although legal liability can have many roots, it is the liability brought about by negligence which has the greatest impact upon insurance. A tenet of common law has always been that the individual has the societal obligation to act in a prudent and reasonable manner. To act imprudently or unreasonably can be negligent and this behavior, in turn, can hurt another resulting in the negligent party assessed liability for damage done.

The basic rules for determining legal liability include the following concepts:

- 1) a duty to act or refrain from acting in a certain way existed; and
- 2) the duty was breached (and therefore the negligence occurred); and
- 3) **actual** damage or loss took place; and
- 4) the negligence on the part of the offending party **was** the proximate cause of the damage (loss).

All of the preceding elements must be present to establish legal liability. For instance, if we have elements 1, 2 and 4 present but no damage or injury, how can a recovery for damage be possible?

Furthermore, the negligence which took place **must have been the proximate cause of the loss** which took place; otherwise the damaged party cannot collect. The legal doctrine of proximate cause is based on the concept of an unbroken or continual chain of events which flow from point A and cause point B. If anything intervenes from point A to point B then it becomes more doubtful that A caused B. If a specific negligence was the cause of an injury that means the accident could not have otherwise happened.

Is the negligent party held only to the **direct consequences** of his act? No, he is also held to all consequences naturally flowing directly from the negligent behavior. It was earlier mentioned that an **intervening cause** makes proximate cause doubtful. An **exception** to the concept is when the intervening force was **foreseeable**. *For example, setting an uncontained fire to burn garbage on a windy day can lead to fire spreading to a neighbor's property. **While the argument that the wind caused the damage as an intervening cause will be put forth, it is the fact that the result was foreseeable which fails to mitigate the responsibility.***

Historically, determining legal liability was fairly cut and dried with little patience or compassion applied to offenders. The Roman Law rooted in "les talionis" or law of retaliation, applied the rule of strict and absolute liability even to negligent acts. For instance under the law of retaliation, if your horse got loose in the street and trampled to death a local merchant, you would likely be put to death for your negligence.

As the law evolved, someone undoubtedly reasoned that it made more sense to keep the negligent offender alive instead of putting him to death. An offender who remained living could pay damages to the family of the person whose death he caused. As courts backed away from absolute liability, the doctrine of negligence was formed. Under the legal doctrine of negligence, a person can not be liable unless fault or negligence has been proven.

### **Exemptions to Legal Liability**

Since the idea of being negligent assumes the ability to reason in the first place, under the **"infant" exception**, children must attain the "age of reason" before being held accountable for negligent behavior. Some states arbitrarily use the age of seven while many others utilize the subjective standard of establishing the age based upon the child's grasp of the difference between right and wrong. **Children under the age of reason cannot be held liable while children at or over the age of reason are responsible for their tortious behavior.**

Under common law principles, **government bodies were always exempt from civil action** unless they granted permission to a plaintiff to file suit against them. The rule stems from the old English maxim the "king can do nothing wrong".

Government bodies today, on both state and federal levels, have weakened or eliminated immunity from civil action. **A federal law makes the government liable for monetary damages to the same degree as for private individuals.** There are a few states which still adhere to the immunity doctrine, but they do not extend its powers to employees of the government. Although the state may not be sued, the employee of the state can be held accountable financially for their negligence while performing duties at work.

**Mental incompetence** is the third major area of exception for negligence. The mental incompetent is **grouped together with the infant.** Neither party can be held accountable to uphold a reasonable standard of care. In the event an incompetent can be held to demonstrate care by being deficient to some extent but still somewhat capable, then it is possible for a court to hold such a party liable.

## Establishing Negligence

The individual is held liable when failing to exercise a reasonable standard of care. The major issue becomes determining the correct care required for any given situation.

The "**prudent man rule**" is used to evaluate individual behavior in determining right and wrong adherence to the standard. The concept applied is: What would a normally prudent person have done in the same or similar circumstance? The further your behavior was from the determination, the more likely your liability.

A judge or a jury will decide whether or not a duty was reached, but the initial burden to prove negligence is on the complaining party, also known as the plaintiff. **There are various legal rules which place the burden of proof, and possibly liability, on the defendant.**

**Negligence per se** is imposed by written state law. When a specific law has been disobeyed and the issue of negligence is present, the burden of proof shifts to the defendant because his actions are "negligence of itself" (the English translation of negligence per se).

The doctrine of **absolute liability**, also referred to as strict liability, is automatic liability regardless of establishing fault. The area of Workers Compensation is a prime example of the absolute liability rule in operation. Your employee becomes injured on the job and the employer is liable - case closed! The worker need not assert employer negligence in collecting damages for loss. Another use of absolute liability is when inherently dangerous activities are involved. If your neighbor's hobby involves mixing explosives in his basement, then he is financially responsible for any damage which results from his dangerous activity. No one will have to prove the neighbor was negligent to recover.

A third legal doctrine not requiring proof of negligence is **Res Ipsa Loquitur** or "**the thing speaks for itself**". The result happened only because someone must of been negligent, thus the idea that the thing speaks for itself. The evidence is so compelling that injury could not possibly have occurred without negligence on the part of someone.

An old Res Ipsa Loquitur case involved a fellow out for a walk on a fine summer morning. As he strode about the bustling city sidewalks of Boston, a piano fell from the sky attempting to occupy the same space at the same time as our hero. Just the very fact that a piano fell from the sky onto the body of a passerby is proof somebody was negligent. Why is this proof, you might ask? It is because pianos, as a rule, do not fall onto people unless someone put it in that position in the first place.

The court scene would go something like this: "Your honor on behalf of the plaintiff (what remains of him are his remains) he is dead because he was walking on Mulberry Street where the defendant was moving a piano out of a fourth story apartment. The piano fell on my client, killing him." To which the judge will reply, "I have heard enough, the defendant is liable -- next case."

***There are three conditions which must be present for the invocation of the Res Ipsa rule:***

- 1) the incident must be one which only could occur because negligence took place; and
- 2) ***the cause of the injuries must be within the exclusive control of the defendant; and***
- 3) the person injured must not have contributed to his own injury.

## **ASSESSING DAMAGES**

Simply because one party was careless and negligently harmed another party does not necessarily mean the injured party will collect damages. An actual injury must be shown before seeking any type of monetary recovery. For example, the mere fact that someone is embarrassed by falling across a garden hose that is carelessly laid across a sidewalk will not entitle the embarrassed party to money. A simple wounding of pride without a demonstrative injury is just not sufficient to win an award.

**The types of injuries that can be compensable include bodily injuries and property damage.** Property damage can easily be determined and is very **objective** in nature. On the other hand, when it comes to **bodily injury**, many factors are involved which are on a **subjective** level. Arriving at a recovery figure for subjective damage evaluations is much more difficult. For instance, if someone drives their car into your front porch, objective estimates about what it will cost to repair the porch can be obtained. This would not be a difficult matter. However, suppose you were sitting on the porch when the car ran into it and you suffered several broken bones, leading to a leg amputation. Establishing the award for damages would involve the considerations of many factors.

The three basic types of damages that can be awarded for bodily injury are:

1) **Special damages** are those damages that are objective in nature and can be easily calculated. They include such expenses as doctor bills, hospital bills and lost wages due to the inability to work during the recovery period. In our example above, if the doctor bills and the hospital stay totaled \$50,000 and lost wages equaled \$15,000, then the total special damages here would total \$65,000.000 and lost wages equaled \$15,000, then the total special damages here would total \$65,000.

2) **General damages** on the other hand, *are subjective and therefore more difficult to calculate due to their intangible nature*. General damages compensate injured parties for their “pain and suffering” compensated. It is in this area of general damages that people sometimes ask for ridiculous amounts of money to be awarded. In fact, sometimes ridiculous amounts of money are awarded.

In our example above, it was stated that the injured party lost a leg in the accident. If the amputated leg was replaced with prosthesis, how much pain and suffering would that be worth? It would depend on many circumstances and factors. Was the injured party a professional athlete? If he were, his

compensation and general damages would be much greater than someone who was already an invalid confined to a wheelchair.

3) The third type of damage is called **punitive** or punishing **damages**. In punitive damage situations, a judge or jury is trying to send a message not only to the defendant in the particular case, but also to all others who might engage in the same or similar behavior that the defendant practiced. Before punitive damages are usually awarded there is either gross negligence or willful intent by the defendant.

Punitive damages go beyond reimbursing the injured party for their special or general damages. The monetary awards of punitive damage usually bear no relation to the actual injuries involved. Instead they are related to the type of behavior involved that the court is attempting to punish.

Also, relevant in the discussion of damages is the **collateral source rule**. Suppose a person who suffered bodily injury wins a lawsuit against a negligent party and recovers for injuries from other sources, such as insurance or a fringe benefit from employment. Such a collection of damages will not allow the tortfeasor to have the amount that they owe reduced simply because the injured party has other

sources from which to recover for their injuries. The collateral source rule is therefore **designed to prevent a negligent defendant from the avoidance of paying for the injuries and damages they actually caused simply because an injured party has already collected some or all the damages elsewhere.**

### MISCELLANEOUS LIABILITIES

Several other liabilities exist including joint and several liability, duties of property owners to others and the notion of vicarious liability.

**Joint and several liability** is a legal doctrine that allows the injured party, or plaintiff, who is awarded a judgment for injuries to enforce that judgment against more than one defendant or tortfeasor, either as a group or as an individual. The injured party could collect 90% of the injury from defendant "X" (who could afford to pay it) and 10% from defendant "Y" (who has very limited resources) even if the defendant "Y" were 90% at fault. Great critics of the joint and several liability doctrine point out that it simply allows injured parties to go after the deepest and fullest pockets to recover. Some states have replaced this system opting instead to make parties pay based on their percentage of the fault in the matter rather than upon their ability to dig into their pockets and pay.

Another misconception regarding liability is **the obligation that a property owner owes to** people who come upon the land. The four categories of people we are concerned with for liability purposes include *trespassers, Invitees, licensees, and children.*

Perhaps the greatest misconceptions of all are those associated with **the trespasser.** The trespasser comes onto your property with

- 1) absolutely no right to do so
- 2) with no permission from the owner, and
- 3) they have no business being on the property.

What rights does the property owner have? Many **misinformed individuals think that the land owner can do anything they wish to a trespasser,** once a trespasser's been discovered. The right to causing the trespasser great bodily harm or even death for the simple act of trespassing does not exist in our legal system. If you shoot a trespasser just because you did not like the fact that he was on your property, and you point it out to the police, you will probably get a life sentence in prison for murder. The trespasser may be removed from the property only using force necessary to accomplish that goal. **Force that would**

**cause bodily harm or even death can only be used if the landowner was being threatened and had a reasonable fear of personal danger that might result in serious bodily harm or death.** Under such circumstances, if self defense is the only way out, a trespasser's life can be taken without retribution by society.

**Invitees** have actually been extended an invitation by the owner to come onto the property. Not only is the invitee there at the wish of the owner but he is also present for the benefit of the owner. The care owed to an invitee is a high standard of care.

Since the invitee is there specifically at the request of the landowner, this person is entitled to know of any dangerous conditions or activities that can carry a risk of harm. The landowner owes the invitee a very high duty of "due care."

A **licensee** is on the property while the property owner knows about it or allows it; however there is no benefit to the landowner. The licensee is owed a standard of care above that of a trespasser but one that is not as strong as one owed to the invitee. The landowner must protect the licensee from dangerous conditions by making them aware of their existence.

As with a trespasser, the licensee cannot be intentionally harmed by the landowner without reasonable legal cause. An example of a licensee would be a door-to-door salesperson. The door-to-door salesperson is not a trespasser. To make the landowner aware of their purpose for being on the land, the licensee must come onto the property and announce his presence. On the other hand, when comparing a licensee with an invitee, the very high standard of due care is not required. A letter carrier, for example, is an invitee. Although few people probably have never expressly given them permission to come onto your land, they must do so to provide their service of delivering the mail.

***Children are owed the greatest duty or responsibility of care by the landowner out of all four classes of people.*** The reason is that children do not always behave in the wisest manner. Therefore, the adult property owner must look out for them and save them from themselves. An **associated legal idea is the attractive nuisance doctrine** that places the highest standard of care upon the owner for conditions on the land considered to an attractive nuisance. Under an attractive nuisance, the attention of a child who is quite young is attracted. This attraction will probably lead to an injury of the child. Before this doctrine applies, the injured child must be very young, usually

less than 12 years of age. Furthermore, the landowner is also charged with the care level of discovering any children who may be on the property and must further protect them from any possible harm or serious injury.

The third area for concern of liability is called **vicarious liability** and it is usually associated with employee/employer situations. Vicarious liability normally exists as the result of state law. The statute generally says that someone while in the employ of another who harms someone in a negligent manner (while actually in the course of their duty to their employer) can yield the result of the employer being held liable for the injury.

AN EXAMPLE: ABC Real Estate sends a secretary to the post office to purchase stamps. She drives her own car and on the way to the post office she makes a left turn without noticing a pedestrian who is then struck by the vehicle.

Because ABC's employee was doing a task for their business, the employer will be held liable for the injury. Risk liability exists under the old **common law doctrine of "respondeat superior."** The phrase is Latin for "let the master answer."

## **CONTRIBUTORY VERSUS COMPARATIVE NEGLIGENCE**

Two distinct legal doctrines have evolved over the years that are applied to the payment of recovery in negligence cases. If one party engages in a negligent act and another party is injured, who is to blame? Is sole blame placed on the party who is predominantly responsible for the injury or does the injured party who contributes in some way to their own injury get barred from recovering any type of monetary reimbursement?

**Contributory negligence** is by far the older doctrine and holds that in order to collect damages; an injured party must have in no way contributed to their own injury. This is a concept known as **the "clean hands' doctrine."** It means that if Party A accuses Party B of harming them and takes them to court over the matter, then Party A must make that assertion with the understanding that Party A had nothing to do with being injured. If it later becomes apparent that Party A was partially responsible to their own injury, no matter how small was their own role in the injury, then in a strict contributory negligence jurisdiction the injured party will not collect.

A more modern view on contributory negligence is to allow some type of recovery if there is some slight negligence involved by the injured party. Some tolerance for small degrees of contributory negligence has been emerging in contributory negligence jurisdictions.

However, this legal doctrine has come under much criticism by people who point out if someone is 95% at fault and the injured party is just 5% at fault, it does not seem right to let the 95% person relieved from any obligation to the injured party. This **doctrine of contributory negligence is only a defense in tort cases when negligence is involved**. It cannot and is not used for intentional civil actions whereas torte fees are knowingly and willfully harms another party.

A more recent development that has been gaining acceptance in more states is the **notion of comparative negligence**. In a comparative negligence jurisdiction, the injured party who contributed to his own injuries does not automatically remove them from the possibility of collecting for their injury. There are two different rules dealing with cooperative negligence. One is called the **Mississippi rule**, by which a defendant who is partially to blame for their own injury must pay in the exact percentage of their assessed blame in the matter.

The other rule (which most states follow), is called the **Wisconsin rule**. Under the Wisconsin rule, the party who is least at fault is not required to pay at all. The Wisconsin rule is further divided into two prongs:

- 1) **the 49% rule** which permits recovery if the injured party's negligence is less than that of the other person; and
- 2) **the 50% rule** holds that recovery is permitted when the injured party's negligence is not greater than the other party involved.

A related idea to contributory and comparative negligence is the legal **doctrine of last clear chance** related primarily to contributory negligence. The last clear chance idea holds that the injury party, who is guilty of contributory negligence, is not barred from recovery if the other party had a last clear chance to prevent the accident but failed to take advantage it. The concept is applied on the belief that if the accident did not need to happen and it could have been prevented, then the party who failed to prevent it should be legally liable without regard to any negligence on the part of the injured party.

## **LEGAL LIABILITY AND FILING BANKRUPTCY**

When an individual is held accountable for negligence and injuring another party, the recovery could possibly wipe out all the assets of a defendant. When faced with a large judgment that might take one or more lifetimes to payoff, the assessed party may not be very enthusiastic about making good on the court ruling. Declaring bankruptcy in a federal court of law is a choice that such a person may decide to elect.

Without the declaration of bankruptcy, the party at fault will lose all the assets they have accumulated to that point in their life plus most future assets obtained. By filing bankruptcy this individual would be released from the requirement of honoring the assessed judgment. Such a discharge of a legally obtained judgment may have the appearance of letting the negligent party off very easily. However, a bankruptcy will likely provide a negative impact to a defendant of his personal financial dealing for the rest of his life.

***On the other hand, a judgment for liability that is the result of willful and malicious actions cannot be discharged from bankruptcy.*** This theory shows the law will not let a person guilty of an intentional and harmful act to gain financially by the release of payment of a judgment.

## **SECTION II: PERSONAL LIABILITY AND THE INSURANCE DEVICE**

### **RISK EXPOSURE AND TYPES OF LIABILITY INSURANCE**

The first section demonstrated that there are many ways in which the individual can become legally liable for an amount of money due to the consequences of negligence. In dealing with risks of this nature, which can be catastrophic in its potential to destroy the financial well-being of the individual, it becomes critical to properly insure with the various methods available against such catastrophic losses. General liability insurance is called a third party contract because it will pay an injured party who is not part of the contractual process.

A contract is between the insured and the insurance company. Once a basis of liability exists because the insured has engaged in a negligent act for which he is legally liable, then the insurance company will pay this previously unknown third party. The contract entered into by the insured and insurance company makes the insurance company pay for all the costs associated with negligence up to the policy limits. The damages

attributable to the insured are paid according to contract in exchange for the insured's timely premium payment. Also included is the concept that the insurance company must pay for any legal defense costs that the insured will incur. However, very few liability cases will ever reach the trial stage since they are normally settled out of court by the parties involved.

If the insurance company denies payment of any particular claim, it is usually for one of two reasons: either the insurance company feels that the insured was not liable for the damages from injuries or the insurance company contends that the loss is simply not covered according to the wording of the contract.

**Basic classes of liability insurance** include liability associated with operating an **automobile**, liability associated with **housing** either as an owner or as a renter and liability associated with owning and running a **business** (IE. workers compensation claims). The details of the potential for auto liability are covered in section 3. The liability potential of driving an automobile is vast and very catastrophic in potential. Therefore automobile associated liability exposure is covered comprehensively in its own right by the automobile liability insurance policy and not by other forms of coverage.

**Housing either by ownership or by rental** can lead to potential catastrophic losses involving personal liability. Again, details of housing liability will be covered in part with this chapter and in much greater detail in Section V and VI. Workers compensation is a business use of insurance. Since this course is focusing on coverages that protect the individual, the general discussion in this area is not included. However when dealing with the personal liability of any individual who happens to own a business, it is critical that the workers compensation risks of exposure are adequately protected against. This means not only by the mandatory coverage to the worker, which is mandated by law, but also through liability coverages available to the employer for his protection that the law does not require.

## **COMPREHENSIVE PERSONAL LIABILITY**

The comprehensive personal liability policy, known as a **CPL**, is **comprehensive coverage against many types of liability** as defined in the broad insuring agreement. *Only those types of liability that are specifically excluded would not be covered. **The CPL does not include business or automobile coverage for the individual or family unit and is designed solely to protect the liability exposure to the individual for all other possibilities.*** The CPL protects the individual

for liability that results from the personal activities of both the insured and family members, either on or away from their living quarters.

*The CPL policy also includes coverage for injury to domestic employees in a state where such workers are excluded from coverage under workers compensation laws.* A maid, butler or gardener who becomes injury while engaged in employment activities would not sue under a worker's compensation theory or recovery. Instead they would bring a personal civil action against their employer, whose only protection would be through the CPL policy. The CPL contract can be bought as a “monoline”, or stand alone contract, or it can be added to dwelling forms by endorsement. CPL coverage is automatically included in a homeowner policy as Section II.

Section II of the Homeowners policy includes coverage E, which is for personal liability and coverage F, which are medical payments to others. Coverage E makes the insurance company liable to pay up to the limited liability set in the policy (usually \$100,000 minimum which can then be increased at very modest cost) for all bodily injury or property damage that is covered according to the insuring

agreement. Coverage F will pay for the medical expenses for parties hurt while on the premises of the insured, but it will not pay any medical expenses for either the insured or the insured's family. The basic amount of coverage begins at \$1,000 and can be increased.

The CPL policy also includes coverage for injury to domestic employees in a state where such workers are excluded from coverage under workers compensation laws. A maid, butler or gardener who becomes injury while engaged in employment activities would not sue under a worker's compensation theory or recovery. Instead they would bring a personal civil action against their employer, whose only protection would be through the CPL policy. The CPL contract can be bought as a “monoline”, or stand alone contract, or it can be added to dwelling forms by endorsement. CPL coverage is automatically included in a homeowner policy as Section II.

## **COVERAGE E**

In analyzing the insuring agreement of a CPL, an insured would find that the language is quite simple:

*"If a claim is made or a suit is brought against any insured for damages because of bodily injury or property damage to which this coverage applies, we will:*

- 1) pay up to our limit of liability for the damages for which the insured is legally liable; and*
- 2) provide a defense at our expense by counsel of our choice. We may make any investigation and settle any claim or suit that we decide is appropriate. Our obligation to defend any claim or suit ends when the amount we pay for damages resulting from the occurrence equals our limit of liability."*

Also, at issue is another idea: **who is an insured** according to the language of the insuring agreement? The typical homeowner's policy defines the insured as any resident of a household including

- 1) a relative and
- 2) any person under the age of 21 still in the care and residence of the insured.

Of course it also includes the named insured's spouse if the spouse is a resident of the household. Sometimes the issue arises about what happens when a person under the age of 21 is living away at college. Is there still coverage for them as an insured under the meaning of the insuring clause? The main issue here is whether or not the student actually has to reside on the premises for coverage and the answer is no. A child away at college is still insured according to the insuring agreement.

In addition to the definition of insured as discussed in homeowners policy above, Section II also means as an insured is covered when he is considered any person or organization legally responsible with respect to animals or water craft to which the policy will also apply. However, the coverage will not apply if the animals or water craft are used in any business. It also includes coverage with respect to a vehicle where any person, while engaged in your employment, or any person using your vehicle at the insured location with the consent of the insured.

**Liability exclusions under section E** of the homeowner's contract includes a set of six exclusions applying to both medical payments and liability. A second set of five exclusions apply to liability coverage only. The exclusions applying to liability coverage include the following:

**1) Intentional Acts** - injure another person's body or damage their property and the contract will not pay. The key idea is whether or not the injury or damage was intended or expected, in the view point of the insured. Also excluded is injury or damage that the insured party would reasonably expect to accrue from his activity.

**2) Business Activities** - the exclusion here clearly prevents any liability, arising from a business engaged in by the insured, to be covered under the policy. It is broad enough to include the denial of coverage for any business activity and it does not matter if the insured is the owner or simply an employee. This is the definition of business activity.

A more ambiguous area under this exclusion concerns part-time jobs for which a salary or earnings are collected. Especially suspect to the exclusion are the part-time jobs of children who are insureds according to the policy definition. If your son is mowing your neighbor's lawn for \$10.00 and accidentally runs over a prize shrub, will your policy cover this? The answer is yes, probably. There is a point at which part-time jobs become involved enough to meet the definition of engaging in a business. However, this is sometimes going into an area with such difficulty of definition that the individual case will depend upon the facts of the circumstances involved

**3) Professional Liability** - this excludes a liability caused by the business pursuits of professionals (such as lawyers, accountants or doctors). This exclusion mirrors the previous exclusion of business activity, but it specifically hones in upon the professional who can obtain coverage under a special form known as a professional liability policy.

**4) Uninsured Premises** - The best way to define "uninsured premises" is to list which type of premises are considered insured. They include the following:

**a)** the residence premises

**b)** a part of any other premises or any other structures or grounds used by the insured as a residence and which is listed in the declaration or which is acquired by the insured during the policy period for use by the insured as a residence.

**c)** any part of a premises not owned by an insured but where the insured is temporarily residing (this could include the rental of a cabin on summer vacation or a hotel or motel room).

**d)** land that is vacant and owned or rented by any insured, if it is not farm land.

e) land owned or rented to an insured on which a one to two family dwelling is being built as a residence for any insured.

f) family or individual cemetery plots or burial vaults of any insured.

g) Any part of a premises occasionally rented to the insured for anything other than a business purpose (for instance, if you rent a hall to hold a reception or party in the hall, this is covered under the policy).

**5) Motor Vehicle** - of the two basic motor vehicle exclusions, the first deals with any motor vehicle designed for travel on a public road that is subject to motor vehicle registration and is being towed. Any liability arising from such motor vehicles is excluded, while an exception to the exclusion here would be a trailer that is not being towed by a motor vehicle.

The other type of motor vehicles exclusions are those vehicles not subject to vehicle registration. These would include such things as motorized golf carts, vehicles used to service the premises of the insured and for helping the handicapped or any vehicles that are in storage on an insured location. All such vehicles are covered. However, go-carts, all terrain vehicles or other off-road vehicles designed for recreational use, which are owned by the insured, are excluded when

off premises. Nonowned vehicles of these types are covered and it does not matter whether they are off or on premises.

**6) Watercraft** - excluded is any liability arising from the use of inboard or inboard/outboard motorboats owned by the insured. Any inboard or inboard/outboard motorboats rented by the insured greater than 50 horsepower, are also excluded. All sailing vessels that exceed 26 feet in length, which are either owned or rented by the insured, are excluded. Finally also excluded are any boats powered by either an outboard motor or motors that are above 25 horsepower, if this motor was owned by the insured at the beginning of the policy but was not listed or reported to the insurance company. It is possible to purchase at a higher premium, larger units for coverage under the watercraft exclusion. Any watercraft that is being stored is covered.

**7) Aircraft** - the ownership and maintenance or use of an aircraft is also excluded under the policy. This exclusion is designed to encourage the insured who rents or owns private airplanes to purchase the appropriate aircraft insurance required. The definition of aircraft is any contrivance used or designed for flight except model or hobby aircraft not used or designed to carry people or cargo (includes hang gliders).

**8) War** - Any property damage or bodily injuries arising out of war, insurrection, civil war, revolution rebellion or similar forms of armed conflict are excluded.

**9) Communicable Diseases** - there is no coverage for any liability arising from the transmission of a communicable disease by an insured. If the policy does not contain the communicable disease exclusion, courts have held that such a loss would be a bodily injury within the meaning of the policy and therefore would be covered.

**10) Sexual Molestation** - added to the homeowner's policy in 1990, the sexual molestation exclusion applies to bodily injury arising from sexual molestation, physical or mental abuse and corporal punishment. Before this revision, the sexual molestation exclusion was used only by endorsement for policies that provided liability coverage for the operation of a child care business in the home.

**11) Illegal Substances** - This exclusion was also added in 1990 to the homeowner's policy and the exact language of the policy excludes liability arising: *"out of the use, sale, manufacture, delivery, transfer of possession by any person of a controlled substance as defined by federal food and drug law at 21 U.S.C.A.*

*Sections 811 and 812. Substances included but not limited are cocaine, LSD, marijuana and all narcotic drugs".* This exclusion does not apply to the legitimate use of prescription drugs by a person following the orders of a licensed physician.

**12) Contractual Liability** - The homeowner's policy excludes two basic types of contractual liability, including any liability assumed under any contract or agreement or liability for the insured's share of any loss assessment charged against all members of any association, corporation or community of property owners. Since liability can be created through some contractual agreements, such exclusion is necessary to control losses.

**13) Workers Compensation** - There is no coverage for bodily injury to any employee of an insured if the employee should have been covered according workers compensation laws. Domestic employees, or those who work within the home, are specifically excluded by state worker's compensation law The employer of domestics can be held liable in a suit of negligence based in common law.

**14) Nuclear Exclusion** - The policy will not cover any bodily injury or property damage for which an insured, under the policy, is also an insured under a nuclear energy liability policy. Nuclear energy liability policies are purchased by nuclear facilities and have very broad definitions of a person insured. Essentially, anyone who is insured under a homeowner's policy is always an insured under a nuclear liability policy.

## **COVERAGE F**

Also in Section II of a homeowner's policy is section F that applies coverage to injuries to parties who do not fit into the definition of the insured. This medical payment to others coverage applies to injuries to others (other than the insured) and in some cases it even extends to situations where the insured is not legally liable.

### **Analysis of Insuring Agreement**

The insuring agreement follows this format: the necessary medical expenses will be paid which are incurred or which are medically detected within three years from the date of an accident that causes bodily injury. Medical expenses mean reasonable charges for surgical, medical, x-ray, dental, ambulance, hospital, professional nursing, prosthetic devices and funeral

services. This coverage does not apply to the insured or to regular residents of the insured household except residence employees. As to others, the coverage applies only to:

a) A person on the insured location or on the location with the permission of the insured or  
 b) To a person off the insured location if the bodily injury:

- 1) arises out of a condition on the “insured location” or ways immediately adjoining.
- 2) is caused by activities of an insured.
- 3) Is caused by a residence employee in the course of the residence employee employment by the insured.
- 4) is caused by an animal owned by or in the care of the insured.

The medical payment is not the liability coverage. Instead it provides payment even though the insured is not legally liable. For instance, if a visitor gets hurt while on the premises, even if the visitor is completely at fault for the injury, section F will still pay for the injury up to the limit stated in the coverage amount. Anyone who is injured according to the definition of coverage can claim directly under the policy coverage.

An injured party does not have to have the permission of a named insured to file a claim. **Coverage F is separate from coverage E** and therefore an injured party can collect benefits under the medical payments section of the policy plus retain ability to sue the insured. As can be seen from the definition of covered expenses, it is very generous up to and including funeral expenses. However the requirement that the expenses be necessary and be incurred and medically calculable within three years of any accident is a prerequisite.

### **Exclusions To Liability**

The liability exclusions under section E were related to such things as intentional injuries, professional activities, business activities, uninsured premises, aircraft, motor vehicle, watercraft, war, etc. In the medical payment section of part F, there are four basic exclusions as follows:

**1) Residence employees who are away from the premises-** medical payments coverage will not be paid for injuries to domestic servants or residence employees when they are away from the insured premises and not engaged by the insured in their normal employment.

**2) Workers Compensation** - the coverage under medical payment excludes payment to anyone who will inevitably receive any workers compensation benefits. Any workers who are injured who come on the premises and are already covered under a workers compensation policy purchased by their employer cannot claim coverage under part F.

**3) Nuclear Exclusion** - *bodily injury that results from any nuclear reaction, radiation or radioactive contamination is excluded.*

**4) Residence On Premises** - this last exclusion prevents medical payments coverage for any person other than a residence employee who is regularly residing at the insured location. The main purpose of this exclusion is to prevent medical payments coverage for roomers or boarders and the tenants of apartments on the premises. Such coverage would exist under a liability section if a party in this exclusion area were injured and sued.

## Additional Coverage

**Claim Expense** - The insurance company would pay all expenses incurred because of the defense of any lawsuit under the policy, including interest on judgments plus certain other legal expenses. ***This is paid in addition to the limit of the liability under section E.*** Also included are expenses incurred by the insured due to cooperating with the insurance company in defending the lawsuit with ***the loss of earnings up to \$50.00 a day paid to the insured.***

**First Aid** - This section obligates the insurance company to pay expenses incurred by the insured for first aid relating to any bodily injury recovered under the policy. These first aid expenses are also paid in addition to the policy limit amount

**Damage-To-Property-Of-Others** - The concept of damage-to-property-of-others coverage is to offer insurance in situations where the property of others is damaged and it was caused by the insured and for which the insured would not be legally liable to pay. It is coverage in for someone who has, what they feel is, a moral obligation -not a legal one- to pay for the property damage of others.

The policy will pay up to \$500.00 for damage to the property of others caused by an insured and it does not matter whether or not the insured was legally liable. The \$500.00 limit is the maximum and there is no opportunity to increase that amount. Typically the wording in a contract will say *"damage to property of others: we will pay up to \$500.00 per occurrence for property damage to property of others caused by an insured"*. A key component of this coverage is that the property involved must actually have been damaged. If it is lost or stolen, it is not covered because that would not be damaged property. There are four basic exclusions to damage-to-the-property-of-others coverage:

**1) Intentional damage** - *is not covered when the insured intentionally damages property and has obtained the age of 13. Under the age of 13, there is a coverage up to the \$500.00 limit for deliberate damage.*

**2) Owned and rented property** - damage to any property owned by or rented to any insured (or of any resident of the insured's household or any tenant of the insured) is excluded. Coverage will exist for damage to borrowed property under damage of property of others coverage up to the \$500.00 limit

**3) Business pursuits, vehicles and uninsured locations** - this section has three parts to the exclusion:

a) all business pursuits leading to damage are specifically excluded.

b) any damage resulting from any acts or omissions concerning the uninsured owned or rented premises.

c) any damage relating to or resulting from the ownership, maintenance or use of a motor vehicle, watercraft or aircraft. An exception to this exclusion would be a reasonable application of the exclusion to nonowned recreational motor vehicles that are not subject to motor vehicle registration.

**4) Losses covered under Section I** - any recoverable amounts are excluded under the damage-to-property-of-others coverage. If Section I will cover a loss, then damage-to-property-of-others would be excluded. (Damage-to-property-of-others coverage has the functional purpose of offering coverage to property damage for which the insured would or should have to pay for but would otherwise be excluded in other parts of the contract).

Section II also has loss assessments coverage that, like Section I coverage, applies to the assessments against an insured by a condominium association or other body of property owners that are cooperative in nature. Any assessments arising out of the legal liability from other type coverage under the terms of a homeowner's liability coverage would apply.

Although the coverage is only \$1,000.00, an increased limit is available by endorsement. This coverage is included for the liability of the insured when they are an elected or uncompensated officer, director or trustee of a corporation association of property owners. The contract does not provide assessment coverage for assessments charged against an insured or a group or any government body.

### **Optional Endorsements**

The homeowner's contract in Section II provides a decent amount of liability coverage for most insureds except automobile coverage. There are many endorsements that are optional and available which will make coverage more comprehensive in dealing with certain specialized risk exposures for particular individuals.

### Personal Injury Liability Endorsements

In personal injury liability policy coverage forms, bodily injury is normally defined as *"any bodily harm, disease or sickness, including acquired care, loss of services, and death which results from any of these causes"*. Since this coverage deals with the aspect of bodily injury only, other possible civil actions such as defamation of character, the invasion to the right of privacy and false arrest do not involve bodily harm. Coverage for these types of civil actions is only provided via a separate type of coverage **called the personal injury liability form**. This type of insurance has been available to businesses for many decades but until recently, it was not generally available to the individual unless purchase an umbrella liability policy was purchased. The homeowner's program in 1976 allowed this new endorsement of personal injury liability so insureds could buy coverage beyond that already granted under a homeowner's policy covering the following groups of hazards:

- 1) Wrongful eviction or entry or other invasion of the right of private occupancy.
- 2) Slander, libel and defamation of character or violation of the right to privacy.
- 3). False imprisonment, false arrest, detention and malicious prosecution.

**There are several exclusions to a personal injury liability endorsement including:**

- 1) *Those where liability is always assumed under a contract.*
- 2) Any injury to the employee of insured.
- 3) The violation of law by or with the knowledge of the insured.
- 4) Business pursuits of the insured.
- 5) Any public or civic activities preformed by the insured.

### Premises Rented To Others

Previously it was noted that all resident premises owned by an insured must be announced in the declaration section and additional premiums paid for each. When the insured owns rental property, the policy must be adapted to provide liability insurance for bodily injury or property damage arising out of the use of such premises. Separate endorsement forms are available for such additional residences that could be rented. Coverage would also extend insuring agreements to portions of the insured's own residence rented to others.

### **Watercraft And Snowmobiling Endorsements**

An insured who owns watercraft excluded by the homeowner's policy (including recreational motor vehicles such as a snowmobile), needs additional liability coverage on these items. **Endorsements can be added** to cover both watercraft and snowmobiles and they **are attached to the homeowner's policy**. It must be noted that the endorsements only provide liability coverage and do not provide reimbursement for any damage or loss to a snowmobile or boat. Because of this lack of coverage for the property value of the boat or snowmobile, most insureds do not choose to add it to a homeowner's policy. Instead they carry the appropriate separate policy that provides for physical damage coverage to these valuable and often expensive items.

### **Liability Umbrella**

An **umbrella liability policy is a broad form of liability insurance coverage for both general liability and automobile liability**. It is purchased separately from and in addition to the separate basic liability contracts of general liability and automobile liability coverage. Before a party can qualify for an umbrella liability policy, they must first purchase specified amounts of liability insurance to cover their

personal liability and automobile liability. These coverages are usually obtained from your automobile liability insurance policy where the liability coverage amount is normally at least \$300,000.00. The same would hold true for the liability coverage amount found in the homeowner's Section II form. The coverage for an umbrella can range from a usual minimum of a million dollars of coverage up to five million dollars of coverage.

The needs for such vast amounts of liability protection deal more with individuals who need to avoid a financial catastrophe if liability were attached to their activities. Of course we are referring here to anywhere from very wealthy people on down to middle and upper-middle class individuals with sizable assets that are more than \$300,000.00. This could be the self-employed business owner or someone with a sizable stock portfolio and a couple of real estate investments. On the other hand it could be multimillionaires who find the umbrella liability policy a useful addition to their insurance portfolio.

Since people with assets could lose those assets in the event they are held liable in a court of law for various activities, a way to transfer that risk of loss is to own adequate amounts of liability coverage. Since the typical homeowner's contract and automobile

policy provide a limited amount of liability coverage, these **excess amounts of coverage** become necessary in order for the wealthier client to protect financial reserves adequately. Obviously a people whose assets are far below the \$300,000.00 minimum level are not candidates for this coverage and need not worry about umbrella liability coverage.

This umbrella provides a secondary layer of coverage beyond the first layer attached to the aforementioned homeowner's and automobile liability coverages. It is considered an excess coverage in that **it will only pay when the basic policy limits are exceeded and more coverage is necessary.** If basic coverage under an auto policy is \$300,000.00 for liability and the policyholder was involved in an accident under which \$900,000.00 of liability is assessed, the basic policy would pay \$300,000.00 and the umbrella would pick up the excess \$600,000.00. The entire claim would be paid.

The **umbrella also provides much broader coverage than one would find under the basic contract.** Umbrella policy coverages will vary from company to company and there is no definitive policy, but most insuring agreements have less exclusion than the basic policies and many losses that are normally

not covered under basic contracts are in fact covered under an umbrella. One example of this would be automobile liability coverage that extends to worldwide coverage without restrictions regarding the use of the automobile. On the other hand, the extended auto policy limits coverage to the USA, Canada and territories of the United States and restricts the type use of automobiles covered.

If a liability claim is covered under an umbrella but not covered by the underlying contract, the umbrella will still pay subject to a self insured retention or deductible. On most personal umbrellas the self insured retention was originally in the \$5,000 to \$10,000.00 range. Today many companies mark their policies with risk retention with a deductible as low as a standard \$350.00 deductible found on basic contracts. This deductible will only apply if the loss is not covered under a basic contract. If a loss is covered under a basic contract, the umbrella would respond from the first dollar once the basic policies are exhausted because the deductible would have paid under a basic policy if one were applied.

There are some exclusions to the umbrella liability policy although coverage is far broader than under the basic individual contract. There is exclusion for owned or used watercraft and aircraft of the type that is also excluded under basic homeowner's policies. Also business pursuits and professional services would be excluded unless coverage for these exposures is also provided in the underlying insurance program. Workers compensation liabilities would be excluded except where employers' liability coverages are provided under CPL'S or homeowner's policies.

***Any action by the responsible insured who wanted intentionally to cause personal injury or intentional property damage would be excluded.*** Also, except watercraft and aircraft, there is no exclusion for property rented to or under care, custody or control of the insured. However, damage to rented watercraft and aircraft is excluded, and property damage by the insured is also excluded.

With the broad coverage and the high coverage amounts associated with the liability umbrella, a prospective insured may think that the cost would be prohibitive. However, just the opposite is true. Premiums can vary from company to company and with the occupations of the insured and other variables

such as the number of automobiles in family and the number of people driving them is calculated in cost. The annual cost for the typical one million dollar coverage is normally in \$100.00 to \$200.00 range. Coverages for additional millions of dollars are respectively less as the coverage is increased. Due to the unique nature of the umbrella liability policy and its inexpensive cost, those with sizable assets will find this perhaps the most valuable policy they will ever own.

## SECTION III : **LIABILITY AND THE AUTOMOBILE**

### **Brief Review of Auto Coverages**

#### **Introduction**

The liability associated with automobile ownership can be catastrophic. Most adults in the United States own or operate an automobile at some point in their life. The possibility of economic loss as a result of automobile ownership and use can be far reaching due to the many possibilities of loss associated with the automobile's use.

**The two main areas of possible destruction in use with an automobile include bodily injury to others or property damage.** When a driver is responsible for bodily injury it can lead to liability for medical expenses, any loss wages during a recuperative period and all rehabilitating costs. The driver will have to reimburse the injured party so that the injured party may be made whole again. Still worse than mere bodily injury is the unintentional striking and killing of a pedestrian or (other party in a struck car) caused by a driver.

When it comes to property damage, striking anything other than people with one's auto is also costly. Whether you run into a fence, a house, a garage, traffic lights, traffic signs, etc. the amount of damage that could be caused by an automobile to property can be staggering. Besides harming the property or body or another, the damage done to the personal automobile, which is an asset (or liability depending upon how many car payments remain) will also be dealt with through insurance. Conversely the automobile itself may end up being damaged or destroyed by someone else, it may catch fire or as commonly happens thousands of times in a day in America, it could be stolen. Through no fault of his own, an auto owner may have to rely on his own insurance for reimbursement if the driver at fault is unknown or did not carry insurance.

The following is a brief review of **four main areas of automobile coverage** including auto liability, uninsured motorists' coverage, medical payments and uninsured motorists' protection.

**Auto Liability** - Automobile liability insurance provides the insured with coverage in the event legal liability accrues when his automobile hurts someone or damages the property of someone else .

Coverage under the automobile liability policy can be written either as a single limit or in split limits, depending upon state regulation. In Illinois, for example, split limits are required and take the form of \$100,000, \$300,000 and \$100,000 coverage. This is normally shortened and recorded as 100/300/100 coverage. **The first two figures deal with bodily injury liability coverage as a limit and the third figure is the property damage liability limit.**

The 100/300 means that **\$100,000 of coverage will be given for injury based on per person per occurrence** while the **\$300,000 limit would apply to all persons per occurrence or accident**. The last figure of **\$100,000 would be for any property damage** which may be accrued up to this limit for any single accident or occurrence.

**Uninsured Motorist** - This coverage deals with the notion that the insured party, through no fault of their own, is injured or their property is damaged by another driver. The protection applies when the other driver either causes the damage and leaves the scene and is an unknown individual or the other party is just simply uninsured. This *coverage would provide the same amount of coverage for bodily injury as the liability section of the insured's policy when the other party*

*is either uninsured or is guilty of a hit and run.* It is through this type of coverage that the responsible individual who owns adequate insurance is not punished for being an innocent victim. When the other driver does not share the same sense of societal responsibility in obtaining insurance coverage, even though most states require it by law, uninsured motorist coverage is quite beneficial.

**Medical Payment** - Medical payments coverage will provide reimbursement to both the insured and members of the insured's family for medical expenses that result from an automobile accident up to the limits of such coverage. The normal range coverage limit is normally from \$1,000 up to \$5,000. Contrary to other forms of insurance where medical payments applies to anybody but the insured, this medical payments coverage in the auto policy applies specifically to the insured as well as to the members of his family. This coverage makes medical payments separate and apart from liability coverage and it is paid, of course, separately.

**Physical Damage Coverage** - This protects an insured's automobile based on **two separate insuring clauses** including other than collision coverage also known as **comprehensive and collision coverage**. Under collision coverage the insured is protected

against impact with other objects as the collision would apply. On the other hand, other collision or what was formerly known as comprehensive coverage is an open coverage providing the protection against most any possible perils that could occur to harm the automobile. The damage to the automobile would be covered regardless of fault.

In the event that the other driver has caused an accident, the innocent party who was injured has the alternative of proceeding against the other driver in a legal action for reimbursement or can collect from their own policy for collision. When the insured who is insured and did not cause the accident elects to be covered by their own policy, then they automatically will allow the insurance company to recover whatever is paid out according to the subrogation clause of the automobile contract. In this manner when the other driver is held accountable for the property damage liability it is their insurance company or their coverage that will pay the loss, not the innocent victim.

## **VICARIOUS LIABILITY**

Because of the rule of **vicarious liability**, one individual can become liable for the negligence of a second individual even though the first person was not present at the time liability was created through an

accident. Most people associate the notion of being responsible financially for the operation of their own motor vehicle when they are the driver. It will be foreign to most that they can be held liable in situations when an entirely different person is driving an automobile.

The application of vicarious liability relates to the philosophy of agency law. In agency law the principal is held financially responsible when an appointed agent acts on his behalf, but does so in a negligent manner. This **extension of liability** from one party to another **is created out of** the centuries old legal doctrine of "**Respondeat superior**". Under the tenets of Respondeat superior, the concept was "let the master answer" for the negligent activities of the servant. Liability is imputed to the master.

*Because of the principles relating to employment, when any employee is operating a vehicle (even their own) for their employer and becomes involved in an accident, the employer can be responsible for all resulting liability.* A conclusion to be drawn concerning the creation of vicarious is that it significantly augments risk exposure to the employer in connection with the use or ownership of an automobile.

A related concept of vicarious liability, although not associated within the realm of employment, is the concept of **the family purpose doctrine**. The owner of an automobile can be held liable for the negligent actions of the members of their household or immediate family while they operate the family car. Under the family purpose doctrine (also related to agency law principles), any member of the family is an agent of the owner (or the parent, in the case of children) of the family car.

When any member of that family uses the family car whether for fun, convenience, etc., the parent/owner will be held liable for at-fault accidents. About half of the states in the U.S. make the parents of a minor, or any person who signs minor's application to obtain a driver's license, liable for any damage created due to the operation of an automobile by the minor for which they have signed. This imposition of liability to the parents of the minor extends also to the use of any car for which vicarious liability is created. Other states have created laws that are even more demanding and assess liability to any person letting any minor causing negligent acts while using their auto

**The vicarious liability laws do not mean that the negligent party is not also financially responsible.** These laws simply make some other some other party (either an owner of a company or parent of a minor)

**jointly liable** for any incurred liability. As you may recall from the previous section's discussion of joint liability, joint liability means someone is going to pay. One of two parties or more can be held accountable thus giving an injured party more accessibility in obtaining a judgment.

## GUEST HAZARD STATUTES

**Guest hazard statutes are referred to as "guest" laws** and they apply to the passengers of an automobile who are traveling in a car when an accident occurs. *These laws prevent the passenger in an automobile from either fully recovering or from suing the owner or driver of that automobile. The notion behind such restrictive legislation is that the passenger and the driver are friends and may decide to commit insurance fraud by splitting any award the injured passenger might obtain.*

Under a guest law, the injured passenger normally can only collect from a negligent driver only if they can prove gross negligence or if the driver was intoxicated by drugs or alcohol. Such a legal definition of gross negligence means that the driver had a complete and total disregard for the safety of themselves or others. Even when gross negligence is involved, in some states, the guest still would not be able to recover if it is determined that they assumed

the risk by getting into the car with an obviously intoxicated or negligence driver. Also, in the alternative, they will not recover if they did not protest when the driver was not performing his duties in a safe and conscientious manner.

Most of these guest laws were enacted during the 1920's and '30's due to the lobbying by the insurance companies who feared many law suits based on the collusion between the passenger and the driver. **Many states have repealed the declared guests laws unconstitutional.** However many states still have those on the books, but courts are starting to apply their rules more narrowly than in the past.

## STATE STATUTORY REQUIREMENTS

The idea of making insurance compulsory when owning or driving a car is a relatively new phenomenon in the insurance market place. **In 1971, only three states had compulsory insurance laws regarding the purchase of automobile liability coverage.** As of the mid 1990's, forty states have enacted laws requiring automobiles registered in the state to have liability insurance or some other substitute in the approved form of security deposits.

In the past, many states required that once a driver was in an accident they had to show proof of financial responsibility. The only problem with this method was that for many people, by this time it was already too late.

Financially responsibility laws mainly take the form of what is termed "putting up security" to comply with the law. Any driver who is involved in an auto accident with bodily injury or damage to property of others occurs, must show that they have the ability to pay any judgment which results from the accident, otherwise they risk losing their license. A driver's license that is suspended would be restored when the security for future accidents is posted as is required by law.

**These financial responsibility laws not only apply to the party at fault in an accident but also to those who are not at fault.** In most states the split limits of liability range anywhere from \$10,000 to \$50,000 per person per accident to \$20,000 to \$60,000 for all persons per accident and from \$5,000 to \$60,000 for property damage. These are the norms.

## THE HIGH RISK DRIVER

Most people who drive are not considered to be high risk drivers and can easily obtain insurance at relatively fair costs. However, there are various groups of drivers considered high risk and who may have difficulty in buying insurance or in paying the high premiums that will be required of them. The group of drivers considered especially high risk in American society is young males, especially teenagers or males under the age of 25 who, historically, have been involved in more than their fair share of accidents. Since insurance companies do not relish losing money, they do not particularly like to deal with high risk drivers.

However, the insurance industry realized years ago that if high risk drivers were systematically discriminated against, the various states might impose some type of a system even less favorable. Therefore the insurance industry has created programs to deal with the high risk drivers so that they might be provided insurance.

In the vast majority of states, the automobile insurance plan is utilized as a "risk sharing pool". All insurance companies who operate in a state will take their fair share of drivers who would otherwise be

rejected by normal underwriting standards. By creating an "automobile insurance plan", the insurance industry has also set up a mechanism whereby the highest risk of insured are equally distributed among all the auto liability insurance companies in the state in which they operate. *In order to qualify for an automobile insurance plan normally the applicant must show that they attempted within the past 60 days without success to obtain insurance from one, two or three insurance companies, depending upon state law.*

Once accepted into the automobile insurance plan, the insurance company will be assigned and obligated to provide the coverage with limits that are at least equal to the financial responsibility requirements of state law or, in most cases, an insurance company will provide higher limits than those required by state law minimums upon request.

*A rule of automobile insurance plans is that applicant cannot be assigned for more than three years to any one company and the right of the company to cancel is usually restricted to nonpayment of premium, loss of driver's license on the part of the insured or for several other very significant offenses, such as drunk driving, while operating a motor vehicle. Although there are hands full of other states that follow some different type of*

plan, these other rules are not significantly different in design. The basic blueprint is to have all companies share equally with high risk insureds and to base acquisition of those assigned to a company upon the actual number of the percentages of business an insurance company does in a particular state.

Historically these automobile insurance plans have experienced loss year after year with accumulative totals surpassing the \$1 Billion mark. Since the insurance companies do not take these losses out of profit, these losses are instead passed on to all other drivers in the form of higher insurance rates. ***Therefore, the automobile insurance plan represents a subsidy to bad drivers by overpayment by good drivers to make sure that high risk drivers have some avenue of coverage.***

In addition to state automobile insurance plans, there are also high risk insurance companies who specialize in bad drivers. However, the special rates that they can charge on the premium are ridiculously high compared to the type of coverage that is provided and therefore many people are faced with the option of either going without insurance or simply not driving.

## **IMPACT OF AUTO LIABILITIES ON CIVIL LAW**

### **TRADITIONAL TORT LAW**

Tort law, or legal actions arising out of civil legal situations, can be traced back hundred of years to old English common law. Society required a system allowing an innocent victim to recover their loss from a negligent party who injured them. **In a tort action, the victim seeks to be reimbursed completely for their loss based upon the assessment that the defendant was in fact guilty of negligence.** However, if the victim had in some way contributed to their own negligence then they could not recover from the other party.

When applied to the legal system of tort law, automobile accidents raise issues of their own. Many critics of the traditional court system have charged that automobile accidents should be handled differently than other civil lawsuit. The main criticisms are that the tort system wastes a lot of money and resources and it can be very expensive and unfair to various victims who, due to no fault of their own, have become injured.

In many jurisdictions, filing a tort action means recovering through the legal system in anywhere from a relatively short time of maybe months up until possibly ten to twelve years depending on the backlogs

in various court systems around the country. For years groups have advocated that the tort system be completely abolished when automobile accidents are involved. The arguments in favor of abolishing tort options include the idea that many people injured are not compensated fairly or adequately. They argue that frequently the amount of compensation that a victim is awarded depends more on how good their attorney is rather than upon the actual facts of a particular case. Critics contend the system is much too expensive and far too many economic resources of the insurance companies are spent employing attorneys rather than helping indemnifying the hurt.

**The issue central issue is: if the court system needs to be changed or eliminated, what will replace it?** There have been many proposals over the years but the one that has endured the test of time has been no-fault insurance and various hybrids.

## **NO-FAULT INSURANCE**

There are many misconceptions about no-fault insurance. Many people toss the terminology around inappropriately and do not fully understand what "pure no-fault" insurance versus "modified no-fault" versus "first party expanded" no-fault is all about.

In theory, the no-fault concept would replace all tort actions by making the injured party go to their own insurance company for compensation rather than suing or going after the other party's insurance company. As long as you were injured and not negligent, your own company will pay your damages. If you are injured due to your own negligence, you should bear the cost yourself either from your existing assets or through some type of "first party" insurance where your insurance company would directly pay you.

With no-fault there is also no blame. There is no burden of loss on who caused an accident because each party would collect for their indemnifications from their own insurance company. Therefore the right to sue under tort or civil actions would be completely eliminated and the innocent victim of the crazed at fault driver would each recover directly from their own insurance, regardless of fault.

There are several distinctions to be drawn from the no-fault concept because several adaptations have emerged over the years. The three basic approaches of no-fault include;

1) **Pure No-Fault** - *this means the tort system would be eliminated for all bodily injuries that are the result of an automobile accident.* In it's purest sense, tort actions would also be abolished for any property damage done to automobiles as well. *All parties who incurred loss or bodily injury could recover for medical expenses, loss wages and other expenses relating to the injury.* This would make the party whole again, but from their own insurance company. However, the **concept of compensating a victim for pain and suffering would be completely eliminated.**

2) **Modified No-Fault** - this is a **limited immunity from tort action** in that the injured party would be paid under the concept of first party coverage through their own insurance. Civil actions would still be allowed but only for losses that were in excess of what was recovered from first party coverage. Depending on the modified no-fault proposal, pain and suffering may be eliminated or limited in some fashion.

3) **Expanded First Party** - Here there is **no exemption or elimination of tort liability.** The injured party again collects benefits through first party coverage, but still has the right to enact a tort action for any losses that are in excess of the amount paid by the first party coverage. Also different about this modification is that the negligent driver still bears a

certain responsibility because the concept of **subrogation by an insurance company would still exist.** In other words, once the insurance company paid under the first party coverage, it could then sue to recover to get reimbursed from the negligent driver or from their insurance company.

Many times all three of these adaptations of no-fault are lumped together and called simply no-fault. Clearly modified no-fault and expanded first party coverage are very much different from the concept of pure no-fault.

## STATE ENACTMENTS OF NO-FAULT

The enactment of no-fault concepts by states began in the early 1970's. Since that time, many changes in adaptations in the definition which constitutes no-fault coverage have existed from state to state. Many states would enact one type of no-fault and then switch it or to modify it a short time later. Most of the states utilizing some type of no-fault in, began that coverage in either the early 1970's or 1990's.

**The concept of pure no-fault is very difficult to find today.** The original concept was to simplify the entire legal system with regards to automobile accidents having the ultimate goal of lowering the cost of insurance for participants. Has this lower insurance cost taken root in no-fault states?

### **COST EXPERIENCE**

Much of the interest in no-fault began with the idea that premiums would be reduced due to the cost experience of no-fault insurance. Many states enacted mandatory initial premium reductions when no-fault was first passed. However like premiums in other states, rates have also increased in no-fault states. The initial concept was the cost of insurance would be reduced because of no-fault. However, now that it has risen many critics are very disappointed in the actual performance of the cost experience of no-fault. Others argue that premium is not the real issue with no-fault. They contend the real issue is do we want a legal system based on court availability or do we want no-fault, which provides the greatest benefits for the most possible policyholders of automobile coverage?

### **THE FUTURE OF NO-FAULT**

At one point in the 1970's, Congress seriously considered making a nation no-fault system. The Magnuson Bill of 1977 also called the Federal Standards Bill, died in Senate Committee. Many states over the years have changed from compulsory no-fault to optional no-fault statutes. Therefore, the lure of the idea of no-fault lives on. In 1988, California put on its election ballot proposition 103, which was an alternative to no-fault. The voters of California approved proposition 103 but after three years of expensive lawsuits based on how it would be administered, and due to the fact the automobile insurance rates were not going to come down, the people of California were not particularly happy with the outcome. Modification or changes in California can probably still be expected.

### **FREEDOM OF CHOICE NO-FAULT**

One of the newest wrinkles of no-fault is to offer the choice between no-fault and the tort system under a concept called freedom of choice no-fault. People could elect no-fault and be compensated for their injuries under their own coverage and would be exempt from tort liability up to the limit specified in

the contract. Individuals who decide to stay with the court system option could then sue or be sued by anybody else who adopted the tort system.

Whatever may happen in the future with the no-fault, it seems that the idea will just not go away. Whether or not it will be successful, be transformed into yet a new variety or even continue to exist, has yet to be determined.

### **AUTOMOBILE INSURANCE COST AND THE RATING SYSTEM OF ISO**

The manner in which insurance companies charge premiums is fundamentally based upon a system which was **adopted in 1965 by the Insurance Services Office (ISO)**. Individual insurance companies may differ in the manner in which they use this standard system, but they all generally follow the same pattern of factors in determining the premiums that will be charged to the consumer. Automobile rating systems begin with five basic factors;

- 1) Age of the driver
- 2) Sex of the driver
- 3) Marital status of the driver
- 4) Use of the automobile
- 5) The individual driving record of the insured

The ISO system uses as a **starting point** a concept **known as base premium** for a particular coverage. The base premium change depends upon the location or territory in which the auto is located, the policy limits of the contract and the value of the automobile. **Base premium equals the charge for a particular automobile for which there are no youthful drivers and the policy stipulates the automobile is for pleasure use only.** Therefore, all other contracts have a premium base which is expressed as a percentage of base premium.

The underwriting department of an insurance company will provide a rating factor for each driver which is based upon the base rate and is expressed as a percentage of base premium. For instance, a driver assigned a rating factor of 2.10 would mean that the driver will pay 210 percent of the base premium, likewise a rating of 4.50 means the driver is expected to pay 450 percent of the base charge. This rating factor is determined the many different variables listed above (the age, sex, marital status, past driving record, use of auto, type of auto, etc. of the insured).

## DRIVER CLASSIFICATIONS

The ISO system uses ten different driver classifications under its rating concept. The **highest ratings are provided to youthful drivers** who are divided by both sex and whether or not they are an occasional or principal driver of the vehicle. Youthful male operators are in the highest category while those who are married are assigned to a separate lower category. Female youthful drivers who are married are considered to be rated in what is called the "all other adult" category. From there, the ranking is divided into female operators, age 30 to 49. The lowest rated class are drivers in the older age group, those from age 65 to 74 and (believe it or not) those aged 75 and older. The general ISO concept divides the ten classes into five for adult operators and five for youthful operators.

There are five categories used that apply to those classes where no youthful operators exist;

**1) Pleasure Use** - Under this category, the auto is not used for business and is not usually driven to work or school for more than three miles each way per day.

**2) Drive To Work Fewer Than 15 Miles** - Under this heading, the auto again is not used in business and is driven to work or school more than three miles but fewer than fifteen miles.

**3) Drive To Work More Than 15 Miles** - Again the car is not used in business but is driven to work or school more than fifteen miles each way.

**4) Business Use** - Here the car is rated based on the fact that it is usually used for business.

**5) Farm Use** - The auto is located at a farm or ranch, is not used for any other business and is not driven by any other employee or to school. It is used for farms, only.

## STUDENT DISCOUNTS

Some youthful operators can enjoy discounts off normal rates applied to them based on whether or not they have completed certain driver's education classes for credit. For a completion of approved driver's training courses the rating factor can be reduced by any where from 5 to 35 points. Another possible discount is called the good student discount which is applied to full-time students 16 years of age or older who, based on certification from authorized school personnel, demonstrate that they either:

- 1). Rank in the upper 20% of their class  
or
- 2). Had a B average or higher  
or
- 3). Had 3.0 average or higher  
or
- 4). Were on the dean's list or honor roll at their school.

The good student discount can result in a rate reduction of from 10 to 65 points depending on what classification the driver appears in.

### **MULTI CAR DISCOUNTING**

When an insured has two or more automobiles insured with the same carrier there is a multi car discount which would apply to the rating factor and each automobile is reduced by .20 points. However depending on the type of car, if the auto is a sports car for instance, there can be an additional charge of .15 to .30 placed upon this rating factor.

### **RATING FAIRNESS**

Whether or not this rating system is fair and equitable to everyone is open to debate. For instance, if the principal driver is an adult age 75 or over and the

automobile is used on a farm, the rating factor in total is .65 or less than the 1.0 which is standard base premium used to assess coverage for all drivers. On the other hand, a 16 year old male who would be the principal driver on a high performance car and who has accumulated negative points for past driving, could be assessed at the rate of 5.50 on the base premium. Everyone else would fall somewhere in between.

A rating system based on the assessment of negative points against a driving record can also affect the rate. For instance, if a party is guilty of a conviction where evidence of financial responsibility under state financial ability laws is scored, two points could be assessed against that driver. One point can be assessed for any conviction or other motor vehicle law violation where the operator's license is suspended or revoked. One point would also be assessed for any accidents causing any bodily injury or death or \$500.00 or more in property damage. Another point would be assigned if there are two or more accidents during an experience period where each resulted in damage to property of \$500.00 or less. No points are assigned under these conditions;

1) The accident occurred when the automobile was lawfully parked.

2) The injured party was made whole by the responsible party or judgment in a civil action was obtained against the guilty party.

3) The car is struck in the rear and the operator who is hit is not convicted of a moving traffic violation in connection with the accident.

4) The operator of the other automobile involved in the accident was convicted of a moving traffic violation.

5) The damage was caused by a hit and run driver and the accident was reported to the authorities within a 24 hour period.

6) The accident involves damage by contacts with animals or birds.

7) The accident involved physical damage to the auto caused by contact due to falling objects, missiles or flying gravel.

8) If the accident happened as a result of responding to an emergency by a party or volunteer member of any police or fire department first aids squad or law enforcement agency.

9). In states where there is no-fault law, payment was made to the insured or operator due to the law and circumstances indicate the driver was not at fault in the accident.

Also any principal operator who has been licensed for less than two years automatically is assessed 1 point. Under the rating system of the ISO, any insured who has a point under the plan has the rating factor increased by 40 points. A second point means an additional surcharge of 50 points. A third point adds a surcharge of 60 points on top of that and a fourth point, another 70 points on top of that. Therefore the driver with four points gets a total surcharge of with 220% of the normal base premium.

### THE FUTURE ROLE OF AUTO INSURANCE

In analyzing where America is today with auto insurance, an interesting shift has occurred from the original purpose of automobile insurance. **When it was first introduced, automobile liability insurance was designed to protect the person who was insured against the financial loss which would be caused due successful tort actions against them.** Recently, states have been enacting laws that make liability insurance mandatory and it has become questionable whether the original motive of helping protect the insured against financial loss is being maintained. *It seems instead the role of automobile insurance has shifted to provide the injured party with a defendant who has the money to reimburse them for their injuries.* The turnabout seems to have auto insurance protecting the accident victim rather than the individual who has caused the accident.

Consider the role of mandatory insurance; is it to protect the injured party or the defendant? A further analysis reveals that the parties most likely to voluntarily purchase auto insurance are those who have something to lose financially, if they cause injuries to another persons body or property. For those who are economically disadvantaged, the purchase of automobile insurance can be viewed as an unnecessary extra expense. It is unnecessary because, if they are sued, they have nothing financially to loose.

When a person does not have any property or any assets they can easily afford to loose that which they do not possess. This is the reason many poor people go without insurance despite the fact the law requires them to have it in order to operate an automobile. In view of this economic fact, it seems that compulsory auto insurance does not solve the problem of the uninsured driver.

## **SECTION IV:** **ROLE OF THE PERSONAL AUTO POLICY**

### **NATURE OF THE PERSONAL AUTO POLICY**

Although there are several versions of the personal auto policy, it is the purpose of this section to analyze the insurance service office (ISO) personal auto policy, or PAP. The "**personal**" auto policy was first written in 1977 and had the original goal of creating a policy which was very much divergent from existing "**family**" auto contracts. The personal auto policy is written in a simple style using the words "you" and "your" to mean the insured and or the spouse and "we" and "us" or "our" to refer to the insurance company. Also, terminology that is legal in nature has been removed and the policy is much more understandable by a person with an ordinary background in education.

**The PAP is one of the most complicated insurance contracts in existence,** but it is complicated out of necessity. Owning and operating an auto can expose the individual to three basic types

of loss including damage or loss to the automobile, injury to the insured and/or member of the family of the insured and legal liability. Legal liability can be imposed in more than one way due to the ownership and operation of the auto.

**The PAP is a package policy because all three types of loss exposure are covered under this one contract form.** There are also various endorsements which can be added to the PAP including uninsured motorist coverage, medical payments and physical damage insurance.

Most adults in America operate an automobile at one time or another and many times the vehicle is not owned by the person who is driving it. This can create various types of complex legal liability situations. The owner of the car can be held liable even when someone else is driving the car when the driver is negligent. *The complicated contract which is the automobile insurance policy, has been designed to cover all of these possible liability situations.*

To qualify for a personal auto policy, only certain types of vehicles may be included in the coverage. The first cardinal rule of qualifying for the PAP is that the **automobile must be owned either by an individual or by a husband and wife who reside in**

**the same household.** Therefore automobiles which are owned by corporations, partnerships or by two or more individuals who do not live in the same household are not eligible. The one exception to this rule would be a motor vehicle owned by a family farm partnership or Family Corporation would be eligible as long as it meets all the existing

The automobile which is to be covered must be a private passenger automobile which bears the definition of "a four wheel motor vehicle not a truck type which is owned or leased under contract for a continuing period of at least six months". No private passenger automobile can be used as a public or livery conveyance vehicle and it cannot be leased to some other party. The pickup truck or van may be qualified for PAP coverage if it is owned by a qualifying individual or husband and wife residing in the same household while meeting the size requirements. A van or pickup cannot have a gross weight of 10,000 pounds or more and use restrictions include delivering or transporting goods and materials. The exception to the use limitation will allow delivery or transportation of goods or materials that are just incidental to the business of installing or repairing equipment for use on a farming or in ranching. The personal auto policy can be used for covering motors homes, motorcycles, golf carts and snowmobiles.

There are **six parts of coverage to the PAP** including

- 1) Part A: Liability Coverage
- 2) Part B: Medical Payments Coverage Part
- 3) Part C: Uninsured Motorist Coverage
- 4) Part D: Coverage For Damage To Your Auto
- 5) Part E: Duties After An Accident Or Loss
- 6) Part F General Provisions.

Parts A, B, C and D are four separate coverages that are included in the policy and each part has its own insuring agreement and bears individual exclusions. Parts E and F will apply to all sections of the policy, whereas Parts A through D since they are separate can all be added, or can be added by section as required by state law.

### **LIABILITY COVERAGE**

The insuring agreement under liability means the insurance company must pay for all damages for which the insured becomes legally liable because of an accident up, to the stated policy limit. **Bodily injury and property damage are both provided for in this**

**agreement and can be subject to either split limits or a single limit.** Depending on state law, the minimal amount of coverage can vary from \$25,000 per accident and this amount can be increased in multiples of \$50,000 and \$100,000 and can be increased to as much as \$1,000,000 of coverage. The insurance company must defend the insured but can make a settlement at any time without the insured's permission. The insuring agreement also makes the point clearly that the insurer does not have to defend the insured once the policy limits have been met and exhausted.

### **IDENTIFYING THE INSURED**

The personal auto policy has four basic definitions of an insured and they include:

- 1) You or any family member for the ownership, maintenance or use of any auto or trailer.
- 2) Any person using your covered auto.
- 3) For your covered auto, any person or organization but only with respect to legal responsibility for acts or omissions of a person for whom coverage is afforded under this part.

4) For any auto or trailer other than your covered auto, any person or organization but only with respect to legal responsibility for acts or omissions of you or any family member for whom coverage is afforded under this part. This provision applies only if the person or organization does not own or hire the auto or trailer.

Although the language is simplified, the meaning is very complicated. The "you" referred to **in the first insuring agreement means the named party** who is listed in the declaration section **as well as a spouse if they are both residents of the same household.** The term **"family member" means any person related to a named insured** either by blood, marriage, adoption, including a ward or foster child, who is a resident of the named insured's household.

The named insured and resident relatives have coverage which **applies to any auto and that means both covered autos** (this will be defined in the next section) **and borrowed and rented nonowned autos.** Even a bus or truck can be included in this definition of auto since no restriction of what may be borrowed and used is listed under the definition. However, inherent in the definition of insured is the requirement of getting permission to use a vehicle. As the exclusion discussion that follows shows, coverage is

eliminated for anyone who uses a vehicle without a reasonable belief that they may, in fact, use that vehicle. **Another part of the insuring agreement as described above extends coverage on a vicarious basis for the operation of an auto.**

Situations may also arise where two policies will cover the same loss. In such a case **where two policies cover the same loss, the policy held on the auto being driven is considered the primary coverage** while the policy of the user who has permission is considered an excess coverage.

*This provision applies only if (provision 2):*

- A) You acquire the vehicle during the policy period;*
- B) You ask us to insure it within 30 days after you become the owner; and*
- C) With respect to a pickup or van, no other insurance policy provides coverage for that vehicle.*

*"If the vehicle you acquire replaces one shown in the declaration, it will have the same coverage as the vehicle it replaced. You must ask us to insure a replacement vehicle within 30 days only if you wish to add or continue coverage for damage to your auto.*

*"If the vehicle you acquire is in addition to any shown in the declaration it will have the broadest coverage we now provide for any vehicle shown in the declarations.*

- 3) *Any trailer you own.*
- 4) *Any auto or trailer you do not own while used as a temporary substitute for any other vehicle described in this definition which is out of normal use because of its:*

- A) *Breakdown*
- B) *Repair*
- C) *Servicing*
- D) *Loss; or*
- E) *Destruction*

## **ANALYSIS OF THE COVERED AUTO**

The ISO personal auto policy definition of covered auto is as follows:"

*"Your covered auto means:*

- 1) *Any vehicle shown in the declarations.*
- 2) *Any of the following types of vehicles on the date you become the owner.*

- a) *A private passenger auto;*  
*or*
- b) *A pickup or van that:*
  - 1) *Has a gross vehicle weight loss of less than 10,000 pounds; and*
  - 2) *Is not used for the delivery or transportation of goods and materials unless such use is:*
    - a) *Incidental to your business of installing, maintaining or repairing furnishes or equipment;*  
*or*
    - b) *For farming or ranching.*

From the above description of "covered auto", it is obviously apparent that the vehicle listed in the declaration is a covered auto. It also states that newly acquired autos will be covered and the insurance company asks to be notified within 30 days of acquiring a new vehicle. However, coverage does apply during this 30 day period to a newly acquired vehicle. The definition is also broad enough to include temporary substitute autos or an auto which is not owned by the insured but is being used as a substitute because the covered auto has been taken out of service because of breakdown, repair, loss or destruction. When this happens, the temporary substitute auto becomes the covered auto.

## EXCLUSIONS

There are thirteen exclusions in the PAP liability coverage. Nine exclusions take away coverage for various described persons while the other four exclude various types of vehicles. The nine exclusions applying to people include:

1) Exclusion for coverage to any insured who causes bodily injury or property damage in an intentional manner.

2) Coverage for damage to property owned or being transported by an insured (such property should be covered under a homeowner's contract or some type of an appropriate floater policy).

3) The care and custody in care exclusion is found here. Coverage is excluded for any insured when damage to property rented to, used by or in the care of that insured is involved (including borrowed or rented property).

4) All injuries to employees during the course of their employment is excluded unless it is a domestic employee in a state where a statute having workers compensation laws not applying to domestic employees exist.

5) If the automobile is being used as a livery conveyance or for public hire, coverage is excluded.

6) Any insured whose employment is in the automobile business, is excluded for purposes of operating that business.

7) Business pursuits of the insured are excluded.

8) Coverage is excluded for any insured that uses a vehicle whether it's not a reasonable belief that they are allowed to use that vehicle.

9) Coverage is eliminated for any insured who's also insured under a nuclear energy liability policy or who would be an insured under this type of policy except for the fact the limits had been exhausted.

The next category of four exclusions applies to the vehicle itself as follows:

1) Any liability due to the use of a motorcycle or other self propelled vehicle with fewer than four wheels or vehicle designed for off public use are excluded. The exception to this exclusion is an excluded vehicle is used by an insured and in a medical emergency situation.

2) Excluded as coverage on any vehicle that is owned or furnished for the regular use of the named insured other than the covered auto. This would cover the example where a car is provided by an employer to the employee. The employee must use the employer's policy for coverage.

3) This exclusion removes coverage due to liability arising out of an auto owned by or furnished for the regular use of family members. An exception to the exclusion does not apply to the named insured's spouse. The intention of this exclusion is to not provide coverage to resident relatives for autos that they own or that are furnished for their regular use.

4) Excluded here is any coverage for any vehicle located inside a facility designed for racing for the purpose of competing in or practicing or preparing for any prearranged or organized racing or speed contest.

### **SUPPLEMENTARY PAYMENTS**

**Supplementary payments are amounts** that the insured is legally obligated to pay in the defense of a lawsuit and for which the insurance company promises to pay **in addition to the insuring amounts included in other insuring agreements.** Supplementary payments include:

- 1) The payment of cost of bail bonds due to an accident, provided that the accident resulted in bodily injury or property damage covered under the policy. The limit of this bond is \$250.
- 2) Premiums on appeals bonds and bonds to release attachments and suits covered under the policy are covered in full.
- 3) Interest on judgment after the judgment has been entered is covered.
- 4) Loss of earnings are reimbursed up to a maximum of \$50 per day while the insured attends a hearing or trial at the company's request.
- 5) All other reasonable expenses which are incurred as a result of the insurance company are also covered.

### **INSURING AGREEMENT**

Medical payments coverage provides for the reimbursement of medical expenses incurred by those who fit the definition of insured in automobile related accidents. The normal liability for medical payments coverage is 1,000 per person and that would apply separately to all people who would be injured in any

given accident. This \$1,000 limit can be raised for a nominal amount of money to \$5,000 or \$10,000 per person. Again there is no limit on the number of people who can collect in an accident. The personal auto policy insuring agreement for medical payments coverage is as follows:

*"We will pay reasonable expenses incurred for necessary medical and funeral services because of bodily injury:*

- 1) *Caused by accident.*
- 2) *Sustained by an insured.*

*We will pay only those expenses incurred within three years from the date of the accident."*

Bodily injury is defined quite broadly in this insuring agreement and includes not only injury but also sickness and/or disease and even death if it is a result of an automobile related accident. Medical payments coverage applies to both the named insured and to any family member who sustains bodily injury caused by an accident while occupying a covered auto. **"Occupying"** is broadly defined: **being in a car, upon it, getting in, on, out or off of the car.** Any accidents relating to getting in or out of cars, such as a

car door slamming on a child's fingers, would be covered under the medical payments coverage of the personal auto policy.

The coverage also extends to the named insured and all family members while they are pedestrians if they are struck by any other motor vehicles which are designed for use on public roads. If the pedestrian goes beyond merely walking, also included are such activities as riding a bicycle and, perhaps, roller skating.

Medical payments has its **own exclusions** and most of them are quite **similar to those found under the previous section under liability coverage** (see liability exclusions). A couple of additional exclusions found under medical payments coverage include: exclusions for injuries caused by discharge of nuclear weapons, civil war, war, insurrection, rebellion, or revolution and any injuries caused by nuclear reaction, radiation or radio active contamination. **The medical payments coverage is also subject to a limit of liability in relation to duplicate payments.** Additional payments will not be made for similar losses under both the medical payments coverage and the uninsured or underinsured motorist coverage.

## UNINSURED MOTORIST COVERAGE

Uninsured motorist protection (which is part D of the personal auto policy) was created to provide the insured and his family with coverage in the event they suffer injuries at the hands of an uninsured driver. Coverage extends to a hit and run driver and a driver whose insurance company is no longer solvent. The insuring agreement of the uninsured motorist **coverage promises to pay the amount of damages that the insured would have collected from the insurance company of the uninsured driver if that driver had owned the proper amount of auto liability insurance.** The standard limit for the coverage is dictated by the state financial responsibility law and higher limits are available for an extra premium.

When the insured is hurt by an uninsured motor vehicle, the definition of coverage includes:

- 1) A motor vehicle that is not covered for bodily injury liability insurance or for which the bodily injury limits are less than the limits that are required by state law.
- 2) Hit and run vehicle.
- 3) A vehicle that was insured at the time of the accident but the insurance company subsequently becomes insolvent.

## IDENTIFYING THE INSURED

The two basic designations of insured including:

- 1) The named insured and any family member.
- 2) Any other person occupying the insured's covered auto.

Both the named insured and family members are protected even when they are not occupying an auto and would be able to recover if they were injured by an uninsured motorist while a pedestrian.

## EXCLUSIONS

There are seven important exclusions under uninsured motorist coverage including:

- 1) Any injury sustained while occupying an owned vehicle that is not insured for uninsured motorist coverage under the policy.
- 2) Bodily injury sustained by any family member while occupying or if struck by a vehicle owned by the insured and covered on a primary basis under another policy.

**3) *If the injured person settles with the negligent party without the insurer's consent.***

4) The standard exclusion of an auto which is used for public hire or as a livery conveyance.

5) The exclusion of any vehicle used without a reason to believe that the person is entitled to be using it.

6) The coverage shall not apply directly or indirectly to benefit any insurer or self insurer under any workers compensation disability benefits or similar laws of the state.

7) Also excluded is coverage for punitive damages under uninsured motorist coverage. (This had to be added because unless it was specifically in the contract, courts ruled that if it was not specifically excluded it may be included).

### **LIMITATIONS TO BENEFIT RECOVERY**

As earlier mentioned, uninsured motorists provides the amount that would otherwise be payable under the coverage had the responsible party had the proper insurance as required by financial responsibility laws. If the uninsured motorist did have insurance but it wasn't enough as required by law, then the coverage

would be reduced by all sums paid on behalf of the party who is legally responsible. Likewise any amounts received by a party under workers compensation law, disability benefits law or similar laws would also reduce the amount that would be payable under uninsured motorist coverage.

### **SETTLEMENT AGREEMENTS**

The question may arise as to whether the injured party can collect from the uninsured motorist as well as from the injured party's insurance company under uninsured motor vehicle protection. This issue is settled according to the written agreement between the insured party and the insurance company. However, if the injured party who was covered and the company aren't able to reach agreement on this point, it may be settled by arbitration.

In arbitration **the insured and the insurance company would choose an arbitrator while each of the arbitrators would select an independent third party who's called an umpire.** It is up to the three arbitrators to decide the issues involved in the case between the insured and the company. If the two arbitrators cannot agree then the third independent party who will be the umpire within thirty days, an umpire would be appointed by the court which has

jurisdiction of the parties. In such a case, both the insured and the insurance company would pay the cost of their own arbitrator while sharing the cost of the empire.

### **UNDERINSURED MOTORIST COVERAGE**

The typical situation of underinsured motorist converge is that the offending driver has insurance, causes the accident and injury but the limit of their insurance coverage is not as high as the injuries caused.

***If the insured injured party has a greater limit of coverage under their own uninsured motorist coverage than the other driver has as an insurance limit, then the injured party collects the excess coverage amount from his or her own policy.*** The injured party is going to receive from their own insurance company the amount that the insurer's company of the other driver would have paid had the at fault driver owned adequate insurance. Underinsured motorist coverage is added by endorsement to the personal auto policy.

### **PHYSICAL DAMAGE COVERAGE**

Physical damage coverage of the personal auto policy is also Part D and it covers the damage done to your automobile. Part D has its own insuring agreement, special conditions and exclusions as follows:

1) Insuring Agreement: This is open perils coverage and the insuring agreement will offer loss by collision only if the declaration section indicates that such loss would be covered. The following is the exact language used in the PAP contract:

*"We will pay for direct and accidental loss to "your covered auto" or any "non-owned auto", including their equipment, minus any applicable deductible in the Declarations. If loss to more than one of "your covered auto" or "non-owned auto" results from the same collision, only the highest applicable deductible will apply. We will pay for loss to "your covered auto" caused by:*

*A) Other than "collision" only if the Declarations indicated that Other Than Collision Coverage is provided for that auto.*

- B) *"Collision" only if the Declarations indicate "Collision" coverage is provided for that auto.*

*If there is a loss to a "non-owned auto", we will provide the broadest coverage applicable to any "your covered auto" shown in the Declarations."*

### **OTHER THAN BY COLLISION LOSS**

This is also an open peril property coverage form which will apply to all losses except any that are specifically excluded from coverage. The policy definition of the perils not considered collision include breakage of glass, loss caused by missiles, falling objects, fire, theft or larceny, explosion, **earthquake**, windstorm, **hail**, water, **flood**, malicious mischief or vandalism, riot or civil commotion, or **contact with a bird or animal**. The above losses are not considered collision losses and are instead covered as comprehensive ("other than collision") losses.

**2) Collision Loss** - Collision means impacting your auto with another object and such collision loss will be paid regardless of the fault of the party involved doing the damage. Such coverage is valid whether or not the insured is at fault. When the other driver is the cause of an accident and they do not have

insurance, the insured driver may collect on their own policy while leaving it to the insurance company to exercise its rights under subrogation to go after the uninsured motorist for reimbursement.

**3) Loss To The Non-Owned Auto** - Physical damage coverage of the personal auto policy will cover the insured's covered auto and the non-owned auto as well. Such loss coverage will be the broadest coverage applicable to any covered auto as shown in the Declarations section. The definition of a "non-owned auto" means:

- A) *"Any passenger auto, pickup, van or "trailer" not owned or furnished or available for the regular use of you or any "family member" while in the custody of or being operated by you or any "family member"; or*
- B) *"Any auto of "trailer" you do not own while used as a temporary substitute while your "covered auto" which is out of normal use because of its breakdown, repair, servicing, loss or destruction."*

Another useful benefit of collision coverage and non-owned auto is in the rental of an automobile from various car rental companies. Car rental companies provide the lessee with automobile insurance for liability medical payments and uninsured motorist coverage but there is no provision for coverage to the lessee for physical damage coverage. Such coverage is usually offered at a quite high cost of from \$7.00 to \$15.00 per day. However, if you carry comprehensive and collision on your own car, this coverage is automatically applied to the non-owned auto which is being rented from the car rental agency. The policy deductible of the renter's PAP will apply to any claims made while driving the rented vehicle.

## EXCLUSIONS

The exclusions to the physical damage coverage are numerous. **Nine of the exclusions apply to the vehicle** and their equipment under specified circumstances **while five of the exclusions apply to the types of property that are excluded from coverage.** The fourteen total exclusions follow. *The nine exclusions applying to specific loss situations include:*

- 1) When the auto is being used for livery conveyance.
- 2) Coverage for damage due to wear and tear, freezing, mechanical, electrical breakdown or failure, and road damage.
- 3) Loss caused by radio active contamination and nuclear weapons.
- 4) When the vehicle is destroyed or confiscated by civil authorities or local government.
- 5) When the non-owned auto is being used and there is no reason to believe that the user has permission to use the vehicle.
- 6) Any non-owned auto damage where the auto is being used by an insured while they are employed in the automobile business.
- 7) Non-owned auto damage when the auto is being used by a person who is employed in any business other than the garage business.
- 8) Any owned or non-owned auto that is damaged while located inside a racing facility.
- 9) Rental vehicle loss when the rental company cannot recover for the loss due to either provisions in the rental agreement or because of the application of state law.

The additional five exclusions that pertain to property itself include:

- 1) Sound and communications systems that are later installed into an automobile.
- 2) A camper or trailer which the named insured owns but has failed to include in the declaration section of the policy (this does not apply to a newly acquired camper, which would automatically be covered within the 30 day period as shown in the previous insuring agreement).
- 3) Awnings and equipment which have been designed specifically to create additional living space.
- 4) Any equipment used in the detection or location of various radar and laser devices by law enforcement officials.
- 5) Any custom furnishings or equipment in pickups or vans including carpeting, furniture, bars, cooking apparatus, sleeping materials and any custom murals, decals or graphics placed on the body of the van.

## **LIMITATIONS TO BENEFIT RECOVERY**

The insurance company must pay for physical damage. The contract stipulates such payment is the lesser of either

- 1) the actual cash value of the stolen or damaged property or
- 2) the amount required to repair or replace the property with other property which is of a like kind or quality.

A new provision added to the 1994 edition of the personal auto policy states that adjustments for depreciation and physical condition can be made in determining what the actual cash value is when there is a total loss. This allows the insurance company more options on settlement of a claim and they reserve the right to repair the damage, replace the auto or pay for the loss in cash. Therefore, the insurance company does not have to pay to make the insured better off than they were before the loss occurred.

## **TOWING COVERAGE**

Towing and labor cost coverage must be added to the personal auto policy by endorsement and the options of coverage here include \$25, \$50 or \$75.00 amounts. This would apply to both covered autos and non-owned autos.

## **TRANSPORTATION EXPENSE**

When the insured cannot use their covered or non-owned auto due to loss, then this coverage will provide money for purposes of renting a car or using public transportation. The personal auto policy's standard amount of coverage is 15.00 per day up to a maximum of \$450.00.

## **POLICY CONDITIONS**

The personal auto policy has a list of duties that any person who seeks coverage under a policy must satisfy before recovery is possible. Once a loss has happened, the insurance company requires the following of the person seeking recovery:

1) They must help the insurance company in investigations, settlement procedures and defending any claim.

2) They must send the insurance company any legal papers that are received due to an accident.

3) They must agree to submit to a physical examination by any doctor selected by the insurance company as often as the insurance company can reasonably require and the insurance company must pay for the cost of such examinations.

4) The right to obtain medical reports must be authorized.

5) A proof of loss must be submitted as required by the insurance company.

### **Additional requirements include the following:**

1. Under the uninsured motorist coverage the party seeking recovery must notify the police when a hit and run driver is involved in a loss.

2) Under physical damage coverage, the insured has to take reasonable steps subsequent to a loss in order to protect the auto and its equipment from additional or further loss. The insurance company will pay any expenses incurred to provide such protection.

3) Also under physical damage coverage the injured must notify the police when a covered automobile is stolen.

4) The insured must allow the insurance company to inspect and appraise the damaged property.

## **GENERAL PROVISIONS**

The following are general clauses found in a personal auto policy. They are nine in number and they include the following:

**1) Fraud** - Any insured who has perpetrated a fraudulent statement or engaged in any fraudulent conduct with an accident or a loss will find that the insurance company has the right to deny coverage.

**2) Coverage Period and Territory** - The policy will only cover accidental losses which happened during the policy period as stated in the Declaration section and all loss must occur within the policy territory. The policy territory includes the United States, its possessions and Canada. There is no coverage under a PAP in Mexico. If you want to drive to Mexico, you must get coverage from an insurance company licensed to write insurance in Mexico.

If you do not purchase Mexican insurance when in that country, you will find that the jurisdiction for both criminal and civil law rests in only one court. They will impound the vehicle, put the driver in jail until they complete an investigation and subsequently have a court hearing on the matter. If the driver has insurance with a Mexican licensed insurance company, the arresting officer has no authority and must waive putting the driver in jail or impounding the auto.

The converse is also true. If the driver has no insurance with a Mexican licensed insurer, he will spend time in jail until they decide to have a hearing on the matter. It is very important to be aware of this territorial concept, especially if Mexico is the territory.

**3) Subrogation** - The insurance company is automatically assigned this right of recovering against an at fault third party to the extent any payment was made by the insurer to the insured. The insurance company is entitled to the cooperation of the insured when exercising this right of recovery. The insured may not block this right of subrogation owned by the insurance company.

**4) Legal Action Versus The Insurer** - The insured cannot bring any legal action against the insurance company until the insured has satisfied all the terms of the policy. Also the person making a claim cannot bring the insurance company into a court action to determine liability of the insured as well.

**5) Bankruptcy** - When an insured declares bankruptcy, it does not mean that the insurance company is relieved under its obligations according to the policy. If the insured bankrupt party is sued, the insurance company is still obligated to pay any part of a judgment that was covered by insurance at the time of a loss.

**6) Covered Changes** - The policy cannot be changed or waived in any manner unless there is an endorsement. If any change requires a premium adjustment, the premium is adjusted according to the date that the new coverage change became effective.

This policy also allows for **liberalization**. If insurance company revises its policy to provide broader coverage without additional premium for new policy owners, it must also extend the same rights to existing policy owners automatically.

**7) Cancellation** - The named insured can cancel the policy anytime by simply notifying the insurance company, while the insurance company's right to cancel is contingent upon the length of time the policy has been in force. When policies have been in force for less than 60 days, the insurer must give 10 days written notice. During periods where the policy in force time has been for more than 60 days, the insurance company can only cancel for specified reasons. These reasons include non-payment of premium, a revoked driver license or obtaining the policy through fraud.

Cancellations for non-payment require 10 days notice while cancellation due to revocation of license requires 20 days notice. Besides cancellation, the company also has the right to terminate a contract by electing not to renew a policy upon the normal expiration date. In such cases, the personal auto policy requires at least 20 days written notice of the intent not to renew to be provided by the insurance company.

All time frames listed in the personal auto policy however, are subject to state laws which may also mandate notification times and dates accordingly. If the law of a certain state specifies more or less days of notification than does the PAP, then policy takes a backseat and the state law would instead apply.

**8) Assignment** - As with all other property and casualty contracts, the personal auto policy cannot be assigned without the written consent of the insurance company.

**9) Other Simultaneous Insurance** - If an insured has more than one policy which applies to the same accident, then maximum payable under all policies held cannot be more than the highest applicable limit of any one of the policies that was issued.

## **THE USE OF PERSONAL AUTO POLICY ENDORSEMENTS**

### **EXTENDED LIABILITY COVERAGE**

The personal auto policy has available dozens of endorsements to provide the broadest possible coverage available to the consumer. Of the dozens of endorsement available, our review will concern itself with the most common of these endorsements.

The **extended liability coverage endorsement is designed to protect the insured driver when utilizing non-owned autos that would otherwise be excluded in the PAP.** This coverage is sometimes referred to as "drive other car coverage" and it applies to various non-owned auto situations including; autos furnished for the regular use of the named insured such as in a business environment, an auto furnished for the regular use of resident relatives (which was otherwise excluded in the PAP), a non-owned auto that is not a private passenger auto but is used by the named insured or resident relatives in the course of business. Also available is coverage for non-owned autos used by an insured if engaged in the business of garaging automobiles.

The extended liability coverage endorsement extends coverage to the above concerns a driver may have. It will cover all of the previously mentioned exclusions except when the car is used in a garage business. The endorsement will apply only to the named insured and a separate premium would be necessary for each and every other person who would also enjoy coverage under the garage endorsement.

### **NAMED NON-OWNER POLICY**

This endorsement is coverage for a person who borrows an automobile from another and who does not own an automobile themselves. It is a "borrower's" policy. It is an excess coverage and does not include any coverage to the automobile owner, only to the borrower. However, in the event the borrower decides to purchase a private automobile, they will have the automatic 30 days coverage granted in a PAP to switch to regular coverage.

### **MISCELLANEOUS TYPE VEHICLE**

There has been an increased popularity in the ownership of miscellaneous vehicles such as all terrain, go-carts and snowmobiles, etc. This endorsement provides protection for those individuals

who own motor vehicles which are recreational in nature. The vehicle types which can command coverage under a miscellaneous type vehicle endorsement includes:

**antique and classical cars, golf carts, snowmobiles, all terrain vehicles, dune buggies, motor homes, trailers used with private passenger autos, motor scooters, motor bikes, go carts, motorcycles and mopeds.**

This endorsement can be used to provide the normal PAP coverages relating to the miscellaneous type vehicles owned while offering coverage for liability, medical payments, uninsured motorists and physical damage.

Because of this broadened coverage, **the definition of "your covered auto" is also expanded.** Coverage is now included to newly acquired miscellaneous vehicles of the same type which is shown in the Declarations. This coverage is subject to the reporting requirements that apply to all additional and replacement autos under a PAP. An example of this broader definition could be: the owner of a motorcycle insured under a personal auto policy who acquires an eligible automobile, would automatically be covered

for 30 days. Applying this new covered definition to the temporary substitute auto demonstrates similar definition expansion. It also includes the notion that **there is no restriction at all on the type of vehicle that would qualify as a temporary substitute.**

**The definition of covered persons is also altered with the miscellaneous type vehicles endorsement.** Coverage will apply, of course, to the named insured as listed in the Declaration as well as family members and any other person (if they had the reasonable belief that they were entitled to use the auto with the permission of the owner).

**The endorsement will provide coverage for vicarious liability** as long as the other person was insured. However, **there is no coverage for the non-owned vehicle** and this applies to everyone including the named insured. **The only possible exception to this non-owned vehicle exclusion is a non-owned vehicle which is used as a temporary substitute for the vehicle listed in the endorsement for use when the regular vehicle has suffered a mechanical breakdown.**

The liability exclusions under miscellaneous type vehicle endorsements are also different than the PAP. **While the PAP excludes any vehicle with less than four wheels, the MTV endorsement provides coverage for any vehicle named in the endorsement.**

Another exclusion, which is optional, is liability to passengers. If the policyholder is willing to exclude liability coverage to any passengers, they can enjoy 20-40% discount. However, this is probably not a wise choice if owner ever wishes to have a passenger in the insured miscellaneous type vehicle.

When applying physical damage coverage to this endorsement, there should be an awareness that the physical damage coverage on the miscellaneous type vehicle will not apply to a non-owned auto unless it is specifically used as temporary substitute vehicle.

If a **motor home endorsement** is sought it must be attached to the miscellaneous type vehicle amendment for a motor home. This endorsement will cover the owner of the motor home but will exclude liability, medical payments and physical damage coverage to the motor home if the insured owner rents or leases the motor home to someone else. All dishonest or fraudulent activities engaged in by the

person to whom the motor home had been rented or loaned would be excluded without possibility of removal of the exclusion. Medical payments coverage for bodily injury to any person, while occupying a motor home while it is rented or leased, is also excluded.

Many individuals own antique and classic automobiles. Insurance for these vehicles also have differences compared to newer automobiles. Although the PAP does not provide a specific dollar limit for physical damage coverage, antique or classic autos can vary in value on a significant basis and therefore a different evaluation process is required. A classic automobile is defined as a private passenger automobile that is ten years old or older, while the antique auto is a private passenger type which is 25 years old or older and is maintained for use in parades, various antique auto exhibitions or other areas of public interest. When a personal auto policy covers an antique or classic automobile there is an endorsement of the "Coverage for Damage to Your Auto" endorsement. There is a specified maximum dollar limit for the classic or antique vehicle and it clearly states, in the limit of liability provision, that the liability for loss is

1) the lesser of the stated amount shown in the Declarations,

2) actual cash value of a stolen or damaged property or

3) the amount necessary to repair or replace the automobile.

The limit of liability which will be shown for physical damage merely illustrates the maximum limit of the recovery possible. (However, bear in mind the actual cash value of the vehicle is comprised of determining the value of the vehicle according to its depreciation and condition).

## **COST FACTORS AND PAP OWNERSHIP LIABILITY**

### **How much liability coverage is enough?**

While it is up to the individual consumer to answer that question for them self, it is quite clear that it is a poor choice to select the minimum limit of coverage that is required by the financial responsibility law of a particular state. Since financial responsibility laws require modest amounts of liability coverage of any where from \$20,000 to \$60,000, not much coverage is provided. This is especially true when considering that the cost to increase the limit substantially is not a very

expensive alternative. For instance, **to increase the liability limit from \$50,000 of coverage to a million, does not require a premium 20 times greater, but one only 50% greater.** Because of the inexpensive nature of the coverage, it seems foolhardy to select low limit amounts of coverage when it comes to liability.

### **MEDICAL PAYMENTS**

The cost of medical payments coverage is also quite low. However, one issue regarding its purchase is that the auto medical coverage duplicates coverage held under an individual health insurance contract. However, the purchaser should bear in mind that medical payment coverage extends not only to the insured and their family members, but to anyone who is considered a guest in the automobile as well. Therefore, its primary use can be to stave off a liability suit brought on by a guest who was injured in an automobile accident that is the fault of the insured. The typical amount of coverage under this form is from \$1,000 to \$5,000.

### **PHYSICAL DAMAGE**

Whether or not individuals purchase physical damage insurance depends upon whether or not they can afford to suffer the loss involved. If an individual purchases a new and expensive car, it will likely be too great a loss for the owner of the auto not to have physical damage coverage. On the other hand, if the automobile which is owned is quite old and has very little market value, then the decision would be an easy one because the physical damage coverage should not be purchased.

The individual who leases a car rather than purchases it would be required by the auto dealership to have specific amounts of physical damage coverage. The only consumer choice available would be how high a deductible the person is comfortable with.

On the subject of deductibles, another choice presents itself when selecting comprehensive and collision coverage. The lower the deductible, the higher the premium is of course the rule, the same as any other type of insurance. It is solely up to the discretion of the insurance purchaser as to what is the individual comfort level when selecting a deductible.

The general consensus is to purchase physical damage coverage with as high a possible deductible as can reasonably be afforded in the event of a loss.

### **UNINSURED MOTORIST**

This type of coverage is a necessity in our society due to a large number of motorists who do not carry insurance, although it is required in most states. Other forms of insurance may protect you in the event that you are struck by an uninsured motorist, but they are unlikely to cover many of the specific damages caused by such an accident. From this prospective it is a wise choice of coverage and it is highly recommended to get the highest possible limits available.

### **COST BETWEEN COMPANIES**

Although coverages available to the auto owner are fairly standard, the cost between companies can vary widely. As with anything else, it is probably not wise just to purchase solely because one company provides coverage much cheaper than another. The insurance purchaser can shop a policy around between companies to evaluate various costs. Bear in mind that the lowest premiums available in the market place will

only be available to the drivers with the best records. There are enough differences between insurance companies so that significant savings may be available to the conscientious consumer.

## **SECTION V: APPLYING THE GENERAL PROVISIONS OF THE HOMEOWNERS POLICY**

### **HISTORY OF HOMEOWNER FORM DEVELOPMENT**

It has only been within the last 40 years that homeowners were able to buy a single policy which covered both property and liability insurance under the same contract. Prior to the 1950's, it was illegal for insurance companies to package property and casualty coverages together under one policy. All property and casualty dealings had to be separate and the main form of coverage for the homeowner was something called the "Standard Fire Policy".

**The standard fire policy only covered a property against damage due to direct loss by fire, the cost of removing damaged property and protection from lightning damage.** Any additional forms of coverage required additional premium and were added by endorsement. The most popular endorsement was called "extended coverage" and the covered perils included were riots, civil commotion, wind storm, hail, explosion, aircraft vehicles and smoke damage.

With the advent of modern insurance, the homeowners form first appeared in 1958 and included the idea of "packaging". This meant both property and casualty risks were covered under one single contract for the first time. Today the homeowners contract consists of two sections; Section I which deals with damage to property and Section II which contains the personal liability coverage forms for the homeowner.

### **OVERVIEW OF BASIC FORMS**

The homeowners forms of coverage consist of such names as HO2, HO3, HO4, HO6 and HO8. Again, we shall use the insurance services office (ISO) basic contracts for the homeowners concept shall be discussed. As of 1990, the numbers pertaining to the forms of coverage were modified to include a double zero between the HO and the number of the form of coverage. For example, HO2 became HO 00 02, and HO3 became HO 00 03, etc.

**The broad form is named perils coverage and closely parallels the dwelling form known as DP2 (to be discussed in a later section).** The broad form, as the name suggests, offers fairly comprehensive coverage to the homeowner but is not as broad as the next form known as HO3.

The **HO3** is called the "**special form**" whose uniqueness provides "all risk" coverage. All risk means that all perils not covered or excluded are listed in the contract and therefore, **every type of loss which is not excluded is be covered.**

The **HO4** is a "**contents broad form**" and commonly is referred to in the insurance industry as "tenant insurance". A renter or tenant of an apartment building could purchase HO4 and it will provide coverage on the renter's personal belongings. It will also protect them for liability for personal injury done to anyone while within their actual premises or living space. If a visitor to an apartment building gets hurt in the apartment of the renter, they would sue the renter for their injuries for liability. In the event the visitor to the apartment got hurt in a common area of the building, such as a stairwell or hallway, then the recourse of the injured party would be to sue the owner or landlord of the building for liability. The **HO4 form does not provide coverage to real estate or real property (a dwelling) but only to personal belongings and liability.**

Similar to HO4, in some respects, is the **HO6 or "unit owners form" also referred to as condo insurance.** The condominium owner does own real estate, but they own it in common with a number of other condo owners. The individual condo owner

actually owns real estate based on a grid system. All condo owners own some percentage of the underlying real estate of the condominium building.

Much like renters insurance, HO6 does not provide coverage for the dwelling but rather for personal property and for liability claims arising from the actual living space of the condo owner. The condo owner would be liable for anybody getting injured while actually on their premises. However, if the party who is visiting the condo owner was injured in a common area, such as a common stairway or sidewalk, then the condominium association would be liable.

Normally a condominium association is composed of all the condo owners who pay an assessment every month for insurance costs on the real estate. The owners also pay a monthly assessment for such things as normal building maintenance, snow removal, lawn care, etc..

Another form is HO8 or "modified form" coverage. This is a very limited type of coverage because the eligibility requirements are not that stringent for the program. It is primarily designed for coverage for older homes whose market value is less than the replacement cost of the building.

## SECTION I COVERAGES

The Underwriting of homeowners insurance include many different forms of coverage which seek to fit the insurance needs of a diverse population. The **homeowner policy is a "MULTI-LINE POLICY" - it combines property (fire) coverage with casualty (personal liability & theft) into a SINGLE CONTRACT.** Use of coverage is restricted to single or two unit residential property only and the owner must reside at the property location.

### **HO -1: BASIC**

**HO -2: BROAD MORE COVERAGE THAN IN HO-1**

**HO -3: SPECIAL OR ALL RISK**

**HO -4: TENANT BROAD COVERAGE FOR PERSONAL PROPERTY OF RENTERS**

**HO -5: REPLACED TODAY BY ADDING AN HO-15 AS RIDER TO AN HO-3**

**HO -6: CONDOMINIUM BROAD COVERAGE FOR PERSONAL PROPERTY**

**HO -8: MODIFIED FORM FOR OLDER HOMES WITH A REPLACEMENT VALUE WHICH EXCEEDS MARKET VALUE (SIMILAR TO HO-1 COVERAGE)**

**HO-15: SPECIAL PERSONAL PROPERTY ENDORSEMENT, IT CAN ONLY BE ATTACHED TO AN HO-3. IT INSURES PERSONAL PROPERTY AGAINST THE RISK OF DIRECT PHYSICAL LOSS NOT OTHERWISE EXCLUDED.**

The greater the HO number, the more expanded the coverage which is offered (applies to HO-1,2,3,5). HO-4 and HO-6 do not provide property coverage for the residence. The HO contract is available to premises which are used for private residences, containing no more than two families and no more than two boarders or roomers per family. A Mobile home Endorsement (MH-200) may be added to an HO-2 or HO-3 policy if the mobile home is designed for year around living and is at least 10 by 40 feet in size.

An analysis of **Section I** shows that insurance is provided against direct loss to buildings and/or personal property which result in payment or any increase in living expenses due to a current occurrence.

There are **four types of major coverage**

### **Coverage A**

**Dwelling** - **The dwelling** that is described in the declarations **and structures attached** to that dwelling are covered. Materials and supplies located on or adjacent to the premises used for construction, repair and alteration of the dwelling or other structures on the premises are covered. This coverage is not available in the HO-4 contract and the HO-6 carries only a \$1,000 coverage amount.

### **Coverage B**

**Appurtenant (Other Structures)** - Provides protection for **structures on the premises which are detached from the dwelling**. Exclusions include structures used for business purposes and any structure rented to anyone other than a tenant of the dwelling. This is not included in either the HO-4 or HO-6 contracts. **10% of dwelling coverage amount (Coverage A).**

## **REPLACEMENT COST**

Coverages A and B, dwelling and other structures, are insured on a **“replacement cost”** basis. If, at the time of loss, the insurance coverage amount upon the

dwelling is no less than 80% of the cost of replacing the building, replacement cost is paid for losses. Replacement cost means the exact dollars needed at the time of loss to replace the item which requires replacement. Physical depreciation is not deducted from the cost as it is with actual cash value coverage.

In evaluating whether or not the insured qualifies for this 80% requirement, the cost of excavations, wiring, pipes and foundation below the basement or ground level may be deducted from cost. Replacement cost only applies to the buildings and not to personal property. Personal property is covered on an actual cash value basis. This is no replacement cost coverage for carpeting, appliances, awnings and outdoor equipment. When the buildings are insured for less than the required 80%, then payment will be the greater of

- 1) actual cash value
- 2) replacement cost in proportion of the loss based on the amount of insurance is in relation to 80% of the replacement value of the buildings.

When the loss is more than \$2,500 or 5% of the insurance amount, then the building must be repaired/replaced before the insured can collect on a replacement cost basis.

Insurable value and market or loan value do not necessarily translate into the same dollar amounts. Market value of real estate is based upon supply and demand factors of a specific area, not to mention variable economic relationships. Market value of a dwelling also includes the value of the underlying land, while insurance value does not.

### **MANAGING THE INFLATION FACTOR**

The main threat to retaining full replacement cost coverage is probably the continuous encroachment of inflation in the economy. As prices of goods rise in general, the real estate market usually hedges upward in value as the greatest single asset most Americans will enjoy. Without adjusting insurance coverages on dwellings to meet increases in value, plus the goods and services it would cost to replace the items it takes to create the value, underinsurance will occur.

The **“Inflation Guard Endorsement”** can be added to the homeowners policy to automatically increase the coverage. The amount will increase by a fixed percentage of the face coverage amount on an annual basis.

### **PERSONAL PROPERTY**

*Coverage C* - Personal Property - Provides **protection for personal property which is owned or used by the insured anywhere in the world.** Personal property of others may be covered while it is on the premises if selected by the insured. Maximum coverage is up to 10% of the Coverage C limit on personal property with world wide protection with a \$1,000 minimum for property usually situated at a residence of the insured which is not shown in the declarations.

Otherwise **the coverage amount is 50% of the Coverage A limit.** On the HO-4 and HO-6 forms, it is available not as a percentage of Coverage A but rather as a flat dollar amount. Under Forms HO 2 AND HO 8 the minimum Coverage A amount is \$15,000 and the personal property coverage amount is \$7,500. The HO 3 dwelling minimum is \$20,000 and the personal property amount is \$10,000.

The simple contract wording for all forms of the homeowners Coverage C amount is:

*“We cover personal property owned or used by any insured while anywhere in the world.”*

### **PERSONAL PROPERTY EXCLUSIONS**

#### **Personal property which is not covered includes:**

- 1) animals, birds, fish,
- 2) aircraft and parts,
- 3) automobiles or motorized vehicles unless the vehicles are used to service the premises,
- 4) any recording or sound reproducing devices while in a motor vehicle, including tapes, records and discs
- 5) boarder's and roomer's property when the individuals are not related to the insured, any property in an apartment which is regularly rented if it is away from the insured premises,
- 6) business property out of the way from the insured premises, business property of a business which is conducted on the premises, business property carried or held as samples for later delivery after sale.

### **PERSONAL PROPERTY DOLLAR LIMITS**

Special Coverage C limits: the **smaller number shown is the normal limit** and the **greater number** in each category represents the **normal maximum to which coverage can be raised, in increments** of \$100 (\$1,000 for jewelry and \$250 for silverware), by the insured for additional premium.

- 1) **money (coins & precious metals also) \$200**, up to \$1,000
- 2) valuable papers (manuscripts, securities) \$1,000 to \$2,000
- 3) **grave markers \$1,000**
- 4) trailers \$1,000
- 5) **watercraft (boat) \$1,000**
- 6) **business property used away from premises \$250**
- 7) stolen firearms \$2,000 up to \$6,000
- 8) silverware, goldware, etc., \$2,500 up to \$10,000
- 9) jewelry, furs, precious stones \$1,000 up to \$5,000
- 10) \$1,000 for loss of portable electronic apparatus while in or upon a motor vehicle.

## COVERAGE D : LOSS OF USE

When an insured residence cannot be occupied due to loss or covered peril, any additional cost incurred from living away from home is covered. The insured will be reimbursed for the time actually required to restore a home to habitability or resettlement in another permanent quarters, whichever is less.

## ADDITIONAL COVERAGES

The following supplementary coverage is provided under Section I of the homeowners policy:

- 1) Debris removal as result of a loss. This includes the removal of volcanic ash plus debris from tree removal when a tree is damaged or felled by a covered peril.
- 2) The cost of reasonable repairs to protect the property from further damage.
- 3) Shrubs , trees, plants and lawns are covered
  - a) *up to 5% of the dwelling coverage amount, but no more than \$500 for each tree, shrub or plant for Forms 2, 3 and \$250 for Form 8. This is known as landscape coverage.*

b) In Forms 4 and 6 the coverage limit is 10% of the personal property coverage amount with the usual \$500 per item limit.

4) Any fire department service charge up to \$500 is paid when the fire department is called to save or protect covered property from any peril covered in a policy.

5) Removal of property from the premises from peril insured for any cause up to 30 days.

6) Credit card loses, forgery, counterfeit money, unauthorized use of fund transfer cards. The policy pays up to \$1,000 due to loss caused by any of the preceding loses.

7) Loss assessment, up to \$1,000 charged by a corporation or association to the owner of a condo or a tenant in a building. 8) Building collapse (not included in HO 8) caused by limited perils, as follows: Coverage C perils, hidden decay, hidden insect or vermin damage, weight of contents, animals, people or equipment, weight of rain on a roof and defects from construction or materials if collapse occurs during construction.

9) Glass breakage is covered when the glass is any part of the building covered (includes storm door windows). Coverage is subject to 30 day vacancy rule.

10) Landlord's Furnishings is included in HO 2 & HO 3.

There is a \$2500 benefit for premises which are rented to others. Carpeting and household appliances are covered by all Form 2 & 3 perils except theft.

11) Building Additions provides the Tenant Form 4 with coverage for betterments to the leased property. The limit to the coverage is 10 percent of the amount on personal property.

12) Ordinance Requirements provides an extra 10% limit of the Coverage A amount for improvements to damaged property when building code upgrades result in extra cost for repair.

13) Deductibles (do not apply to either fire department service charges or to coverage for credit cards, fund transfer cards, forgery or counterfeit money) are available from a base of \$250 up to \$500, \$1,000 or \$2,500.

## OTHER PROVISIONS

**INSURABLE INTEREST** - Insurable interest exists as to any individual when damage or destruction of property will result in a financial loss to that individual. Insurable interest extends beyond mere ownership and even tenants have insurable interest in their own belongings within a building owned by another person.

Under insurable interest, the insurance applicant must:

a) face a personal risk of loss; or

b) have a legitimate interest in preserving the property being insured. Otherwise, he will not receive a potential for gain due to the insurance applied for. **In a property or casualty contract, insurable interest must exist at the time or loss.**

**DUTIES OF THE INSURED** are imposed upon the insured, *in the event of loss*, is "reasonable compliance" in these five areas:

1) **Immediate Notice** - written notice is specified, but telephoning the agent is now deemed to meet this criterion.

- 2) Prevent Further Loss - of property from damage under reasonable conditions. Further damage due to neglect by the insured is not covered.
- 3) **Damaged and Undamaged Property must be separated to determine loss.**
- 4) *Inventory loss* - compile a complete list of destroyed, damaged and undamaged property.
- 5) Claim Verification through checking banks statements and records of the insured must be made available to the company.

**DUTY OF THE INSURANCE COMPANY** - the obligations of the insurance company, according to the contract, are stated in the agreement. **As long as the insured makes timely payments and meets other requirements of the contract, the insurance company is bound to pay in the event of loss.**

**Pair and Set Clause** - When loss to an object, which is part of a pair or set occurs, the insurance company can employ either of the following options:

- 1) To pay the difference between actual cash value of the property before and after the loss.

- 2) Repair or replace any part of the property in order to restore it to its value before the loss occurred.

It is the purpose of the pair and set clause to prevent the insured from collecting fully upon a loss which is only partial and not total.

**Mortgagee Rights-** a mortgagee interest allows a mortgage holder to receive loss settlement up to the of the lenders interest in the property (unpaid principal on a mortgage loan). **When canceling, a company must provide 10 days notice to a mortgagee.** If the insured fails to provide proof of loss, a mortgagee has 60 days from receiving notice of the failure of filing a proof of loss to file the loss themselves. New commercial forms now have a **mortgage holder condition** requiring the mortgage holder to be given a 10 day notice of nonrenewal or cancellation for nonpayment of premium, and a 30 day notice of cancellation for any other reason.

**APPRAISAL** - Each party to the insurance contract selects a disinterested appraiser. Each appraiser chooses an umpire/referee (who will cast the deciding vote when the appraisers disagree) or one is appointed by a court of record. Actual cash value of loss is estimated and sent to the umpire/referee who then sets an amount that is agreed upon by at least one of the two appraisers. That amount is binding for all parties submitting to the appraisal process.

**ARBITRATION** - National panels make a decision to which both parties, in a claim settlement dispute, agree to be bound. This process saves time and money and is very similar to the appraisal concept, above. In modern ISO policies, the Arbitration clause is only found in the automobile policy forms, as part of uninsured motorist coverage.

## **CONTRACTUAL CONDITIONS OF SECTION I & II COVERAGE**

### **FRAUD & CONCEALMENT**

Two contractual terms which are critical to the status of a contract's effect are "**void**" and "**voidable**".

- 1) A "void" contract is an agreement which has no legal effect whatever. It means no contract even exists.
- 2) A "voidable" contract is an agreement that does exist, but whose legal effect can be put aside by a court of law. It would be a binding agreement unless the party who has the right to have it voided (or set aside) wishes to do so.

Also of great importance in the contract formation stage are the ideas of **Warranties, Representations and Concealment** .

**1) A Warranty** is a fact which is sworn to such that a breach of warranty can lead to voiding a contract. A warranty is a much stronger statement than a representation. Breaching a warranty on even a minor point can be cause for setting aside an agreement. In modern insurance contracts, the strict warranty standard is only held against an insured in the ocean marine form of coverage.

**2) Representations** are considered to be statements of fact, in the opinion of the person making the statements. *In order to void a contract on a basis of misrepresentation a party must show that a material fact was misrepresented.* A material fact is one that would have changed the underwriting basis of a policy, had the company known of the material fact. Any minor points which may have been misrepresented will not enable the other party to void an agreement. This is the standard to which virtually all insureds are held.

**3) Concealment** is the failure to disclose a known fact. It is hiding something that should not be hidden even when the particular fact was not specifically asked about. In order to void a contract the concealment must be intentional.

**VACANCY AND UNOCCUPANCY** are conditions limiting coverage when the insured develops a lack of concern about property protection. It is essentially an insurer's protection against a morale hazard.

1) **Vacancy** exists when a property is both unfurnished and not being used by anyone for business purposes or as a dwelling.

2) **Unoccupancy** refers to the fact that a property is furnished or has possessions in the physical structure but no one is using the property for business purposes or as a dwelling.

**LIBERALIZATION**- is a property insurance clause which states that if the insurer makes any changes in the current edition of a policy which broadens coverage without premium charge, such changes are automatically made a part of all existing policies.

**CANCELLATION** allows both the insured and the insurance company to cancel coverage, according to contractual conditions. **The insurance company must give some specified written notice (as required by state statute), but the insured can request immediate cancellation.**

When the **insured is the party canceling** the policy, any **refund** of unearned premiums **is calculated on a short rate basis** (unless state law says otherwise). The short rate basis enables the insurance company to recoup some of the cost of underwriting and processing the policy.

When the **insurance company cancels**, unearned premiums (refunds amounts) are paid to the insured party on **pro rate (pr pro rata) basis**. This **means the insured gets back all of the money which has not been used or applied to premium cost.**

**NONRENEWAL** - **Nonrenewal is notice given by the company** to the insured that the insurance company does not intend to renew the policy upon the normal termination date. Nonrenewal notice affords an insured the opportunity to replace coverage and not have a gap in coverage when the existing policy terminates. The number of days notice required by a company exercises the nonrenewal option is normally 30 days or more.

**PROOF OF LOSS** - must be filed by an insured within 60 days (mortgagees have an additional 60 days to file loss if insured does not if there is an outstanding mortgage loan).

**NOTICE OF CLAIM** or notice of loss provision, means the insured must take certain steps in the event of loss or occurrence in order to lead to a filing a successful claim (receiving a loss payment) under the terms of the agreement. **The insured is bound to notify the insurance company of loss as soon as reasonably possible.** Furthermore, the insured may be required to notify the police if a violation of the law has occurred (i.e. burglary or theft).

**ASSIGNMENT** - Assignment is **the transferring of some or all rights from one party to another.** Assignment of rights held under property contracts is normally valid only with the written permission of the insurance company.

**SUBROGATION (also called Transfer of Recovery rights)** is a clause whereby the insurance company, by assignment from the insured as stipulated in the insurance contract, has the right to recover from third parties any recoverable loss which was reimbursed by the insurance company to the insured during the settlement of the claim.

Subrogation allows the company to step into the shoes of the insured for purposes of recovering losses which have been paid to the insured by the company due to the liability of the third party. Subrogation is a concept

related to indemnity, or the prevention of the insured to profit. In this case, the insured can not collect for sustained damages twice.

**EVENT OF THE INSURED'S DEATH** - when an insured dies, the contract allows the legal representatives of the deceased insured to assume coverage on any insured property.

**SECTION VI:**  
**ANALYZING THE COVERAGE**  
**FORMS OF THE HOMEOWNERS**  
**POLICY**

**COMPARISON OF COVERAGE FORM**

**HO2 - The Homeowners Broad Form** provides insurance for damage to the building, personal property and to the loss of use that results from the damage of any peril insured against. **Coverage for personal property under all the homeowners forms** include the same sixteen perils which are listed below:

- 1) Fire and lightning
- 2) Windstorm or hail
- 3) Smoke
- 4) Explosion
- 5) Vehicles
- 6) Aircraft
- 7) Riot and civil commotion
- 8) Falling objects
- 9) Theft
- 10) Vandalism or malicious mischief
- 11) Weight of snow, sleet or ice

- 12) Sudden and accident damage from artificially generated electrical current
- 13) The freezing of plumbing, heating, air condition or automatic fire protective sprinkler systems or household appliances
- 14) Accident discharge of water or overflow of water or steam from within a plumbing, heating, air conditioning, fire protective sprinkler systems or household appliance
- 15) Sudden accidental tearing apart, cracking, bulging or burning of a steam or hot water heating system, air condition, automatic fire protection sprinkler system or appliance for heating water
- 16) Volcanic eruption

The fire and lightning peril covers a fire which burns down a building or causes other damage. Although there is coverage for fire in the contract, the term itself is not defined in the policy. The court system has taken care of the general definition: **fire is a combustion proceeding at a rate rapid enough to generate flame, glow or incandescence.** In order for there to be coverage under the fire concept, there must be light. Smoke scorching is not solely indicative of fire without the presence of light. The fire coverage extends to coverage for hostile or unfriendly fires. A "friendly fire", which is one that is supposed to remain within its intended confines, would burn where it is supposed to be burning.

Windstorm and hail coverage excludes any damage that is caused by rain, snow, sleet, sand or dust which occurs to the inside of a building unless the outside of the building or roof was damaged due to the direct action of the wind or hail. Any damage that would occur to the inside of the building due the neglect of the insured would be excluded.

Riot and civil commotion covers any damage done by rioters, with very limited exclusions. Pillaging and looting are covered if they happen at the time and place of the general riot. There is some problem in the **distinction between the definition of a "riot" and "insurrection", however.** Losses caused by war are excluded in the homeowners form. The idea of an insurrection may not meet the definition of a riot, which is a tumultuous disturbance of the peace by three or more persons. An insurrection has, as its center of intent, the idea of overthrowing an existing legal government.

**Aircraft coverage** is provided to the insured property against any self propelled missiles or space craft parts that might damage the property. This includes damage that is the result of direct physical contact with the insured property by an aircraft and it also could include aircraft noise, such as a sonic boom.

**Vehicle damage is covered even if the insured owns or operates the vehicle causing the damage. The only exclusion would be the fences, driveways or walks damage done by owned vehicles of the insured.**

**Smoke damage** from a hostile fire is also a peril covered. Exclusions to the smoke peril are smoke damage that is a result of agricultural or industrial smudging operations.

**Vandalism or malicious mischief** is damage done to the property of others due to willful and malicious destruction of the property. If a building has been vacant for more than 30 days, the vandalism peril will not be covered. The logic behind this denial of coverage is that if the insured is present continuously, vandalism or malicious mischief is less likely to occur. The attitude of the insurance company seems to be: if the insured is not present and doesn't seem to care, neither does the company. Any dwelling that is being built at the time of construction is not considered to be a vacant property.

**Theft coverage forms are identical in all the homeowners policies except for form 8.** The theft peril provides **coverage for "theft, including attempted theft** or loss of property from a known location when it is likely that the property has been stolen".

Such language relieves the insured of the burden of showing that the loss actually happened due to theft, especially when there is not adequate proof available. The only requirement under the contract is that the insured must immediately notify the police when property has been stolen. **General exclusions to theft include:**

- 1) When the insured commits the theft.
- 2) When a dwelling which is under construction has materials and supplies that are used in the construction are stolen before the dwelling is completed and occupied.
- 3) If a residence is rented by an insured to anyone except another insured, all theft would be excluded under this condition.

## PERIL EXCLUSIONS

- 1) **Loss caused by the enforcement of any law or ordinance** that regulates the building, repair or demolition of any building is excluded.
- 2) **Earth movement** - This eliminates coverage for losses caused by the earth moving except when direct loss is from fire, explosion, theft or the breaking of glass.

The policy specifically defines the movement of the earth as "earthquake, including land shook waves or tremors before, during or after a volcanic eruption: landslide: mine subsidence, mud flow, earth sinking, rising or shifting".

**3) Water damage** - Water from floods and backup of sewers and drains and overflow of sump pumps is excluded as is water which is below the surface of the ground which seeps through basement walls, foundation walls, etc.

**4) Power failure** - Coverage is excluded when loss is resulted directly because of the interruption of power and utility services when the interruption takes place away from the resident premises. Therefore as long as loss takes place as a result of the power failure on the actual premises, coverage will exist.

**5) Neglect** - Any loss that results directly and indirectly due to neglect of the insured, he uses reasonable means to prevent the loss, is excluded. This prevents the insured from collecting for damage that they had a reasonable chance to avoid.

**6) War** - All loss due to war in any form including undeclared wars, insurrection, rebellions and revolutions is excluded. And any nuclear weapon which is discharged, even accidentally, is still excluded under the contract language.

7) **Nuclear hazard** stipulates that losses from nuclear hazards are not covered and this includes nuclear reactions, radiation and radio active contamination.

8) **Intentional loss** which is defined as loss by "by or at the direction of the insured" "with the intent to cause a loss".

### HO3 - OPEN PERILS COVERAGE

The main difference between HO2, the broad form, and HO3, the special form, is that **HO3 coverage is on an open perils basis for dwelling and other structures**. Open perils means that a set of exclusions are listed and if the cause of loss is not one of those exclusions it will be covered. Although the real property is insured on an open perils basis, **personal property is insured on a named perils basis**. Other than this open perils basis coverage difference, the form 3 and form 2 are exactly the same.

### EXCLUSIONS

Open perils exclusions in HO3 are:

1) Wear and tear or deterioration

2) Inherent vice, latent defect or mechanical breakdown

3) Rust, mold, wet or dry rot

4) Smog, smoke from agricultural smudging or industrial operations

5) Release, discharge or dispersal of contaminants or pollutants unless caused by one of the named perils for which personal property is insured.

6) *Settling, cracking, shrinking, bulging or expansions of pavements, patios, foundation walls, floors or ceilings.*

7) *Damage caused by birds, rodents, vermin or insects.*

8) *Domestic animals owned by the insured.*

An exception to these exclusions is that, if one of the excluded perils is the basis for leaking water from plumbing, heating, air conditioning or fire sprinkler systems or appliances, then the damage would be covered.

## CONCURRENT CAUSATION

Recent Form 3 language includes three related exclusions referred to as concurrent causation exclusions. The **first part of concurrent causation deals with any loss caused by weather conditions that will contribute to a peril** which otherwise is not covered. For instance, in order for there to be coverage, the loss has to be directly caused by a weather condition that is covered or not excluded. The **second part of the exclusion deals with loss caused by any actions or decisions of any person, group, organization or governmental body.** This also includes the failure to act or to decide by the above named individuals. The **last part of concurrent causation excludes loss caused by faulty or inadequate design, maintenance or the use of faulty materials,** including defective activity, such as poor planning, in the construction of the covered dwelling.

There is **also a general exclusion** referred to as "dwelling and other structures" exclusions. The first exclusion in this area deals with the **collapse peril.** Under additional coverage, the collapse peril is a named perils coverage, however the intent of the language has been to exclude from collapse coverage any collapse resulting from excluded perils such as flood, earthquake or planning and design error. The

other exclusions can be found in the discussion under HO2 (freezing of plumbing when the building is vacant, freezing, thawing, etc.).

## HO4 - ANALYZING THE TENANT NEED

**HO4 is called the Contents Broad Form and is often referred to as renter's insurance.** The theory is that the renter is using real estate on a contractual basis and no real property ownership exists. This will eliminate the need for any coverage on the dwelling or structure and instead focus the coverage needs on personal property liability coverage. There is a difference in the insuring agreement of HO4 compared to HO2 broad form in that there is building additions and alterations coverage which applies to the tenant and is usually referred to as tenants' improvement and betterments. These improvements can include building additions, alterations, fixtures, improvements or installations made by the insured in a rented apartment or dwelling. The coverage amount on the building additions and alterations is limited to 10% of the coverage on contents.

## HO15

**HO15 is called Homeowners Special Personal Property** coverage endorsement. It offers open perils coverage on contents and is added to Form 3 to provide open perils coverage on the building and the contents. The HO15 rider to the HO3 open perils coverage was designed to replace the HO5 form from earlier ISO contract language. This special personal property endorsement eliminates the perils covered for coverages A, B and C and instead uses the following language

*"We insure against risks of direct loss to property described in coverages A, B and C only if that loss is a physical loss to property".*

The exclusions are the same open perils exclusions applying to the dwelling under an unendorsed HO3 special form. Such exclusions apply to all coverages of Section I. Another set of exclusions applies to the dwelling and other structures and is comprised of the usual exclusions of vandalism, malicious mischief, glass breakage, 30 days limitation on vacancy, repeat seepage or leaking of water taking place over a period of time and collapse. The last group of exclusions deals with the personal property coverage. **These are new exclusions which do not pertain to other forms including:**

- 1) Breaking eyeglasses, glassware, statues, marble, porcelains and fragile articles, unless they are caused by a specifically named peril.
- 2) Damp atmosphere, extreme temperatures, unless the direct cause of loss is in fact weather, snow, sleet or hail.
- 3) Refinishing, renovating or replacing property except for jewelry, furs, etc..
- 4) Collision except for collision with land vehicles or sinking, swamping or stranding of watercraft including their trailers, furnishing equipment or outboard motors.
- 5) Destruction and confiscation or seizure by order of any governmental or public authority.
- 6) Acts or decisions including the failure to act or decide of any person, group, governmental body, or organization.

The theft coverage language under the HO15 is unique among coverage forms. **Theft is not covered as a named peril but due to the broad open perils coverage of HO15 coverage for loss of real or personal property by theft is included.** There is **just one exclusion** found under the form 15 and that is **if theft is in a building that is under construction and**

**prior to the completion and occupation of the structure.** Typically a named perils form set of exclusions include theft by the insured, theft from unlocked vehicles or watercraft while they are away from the premises and theft to second homes. However under Form 15 they are not excluded and are covered. Besides theft, the coverage applies also to loss by lost or misplaced property as well as having it stolen.

### **HO6 - ANALYZING THE NEED OF THE CONDOMINIUM OWNER**

The risk of loss to the condominium owner is unique due to the manner in which ownership of the real property exists. A condominium is a structure made up of many individual dwelling units shared by different owners. While everyone has their own space or living quarter, there are also common areas (hallways, walkways, etc.) to which all unit owners enjoy real property ownership as tenants in common. While the individual owner of a condominium will have a concern similar to a renter, because they need contents coverage and protection from liability in their living space, there is also the risk of loss inherent to real property ownership

The real property of the condominium owned in common with the other owners is insured through a condominium association to which all occupants or condo owners pay fees for the upkeep. The fees are not only for the upkeep of the exterior and common areas but they also apply to property insurance and liability coverage which is purchased for all the condominium owners for the common area.

### **BASIC ENDORSEMENTS TO HO 6**

In order to enjoy greater coverage, this endorsement includes:

- 1) open perils coverage on personal property.
- 2) Rental unit coverage - This covers a situation where the condominium unit is rented by the owner to another person.
- 3) Open perils coverage on unit owner's building items.
- 4) Assessment coverage - Here loss assessment is automatically included as an additional coverage in form

## HO8

The HO8 contract was created to provide a coverage form under homeowners that would allow the owners of unique types of older property to obtain coverage that they otherwise would not be to get. Many older homes were built in a time when the materials and labor was quite expensive by today's standards. Modern dwellings are built in a cost efficient and effective manner, almost cookie-cutter fashion in some cases. The intensive labor and expensive materials which went into dwellings of the past are not economically feasible today. To modernize the insurance approach for these older homes, the HO8 has a unique clause called **functional replacement cost**. Other homeowners contracts as contain a normal or standard replacement cost provision allowing the replacement purchase to be made in actual present dollars.

Functional replacement cost allows the insurer to repair damage, but they will pay more than what it costs for common construction materials used today, as opposed to replacing the materials and methods used years ago when the home was built. For example, if the original structure had walls which were made of plaster, then dry wall would be the replacement.. Another reduced type of coverage under

this form is the theft coverage which is limited to \$1,000 per occurrence and is only valid on the premises.

## MEETING SPECIAL RISK CONCERNS USING OPTIONAL SECTION I COVERAGES

It is possible for the homeowners forms to be augmented by **endorsements for water backup, earthquake and sinkhole collapse**. Since homeowners forms exclude any water damage including water that backups through sewers and drains and overflows from sump pumps, many people still have a need to have coverage for this possibility. The water backup and sump overflow endorsement **will insure the party for up to \$5,000 for direct loss not caused by the negligence of the insured**. Sump pump damage coverage will exist even if the water damage was due to mechanical problems with the sump pump. There is a \$250 deductible associated with this endorsement.

The **earthquake endorsement** will pay for loss to the insured's property that results from an earthquake or volcanic eruption. However losses due to floods or tidal waves that are a result of earthquake or volcanic

eruption are excluded from coverage. The real estate itself or the land is not covered. Commonly there's a 5% deductible on the value of every item insured under the contract. In areas where earthquakes are more prominent there can be a 10% deductible applied

**Sinkhole collapse coverage is available** on all homeowners form except for HO4 and HO6. In the event the insured property is damaged because of sinkhole collapse caused by underground erosions of limestone or common sedimentary rock caused by water damage. Filling a sinkhole is not covered under this endorsement.

## **SCHEDULING PERSONAL PROPERTY RISKS**

This provides open perils coverage on specifically designated items and has its own contract language as to insuring agreement and requires a separate premium payment. The normal categories of coverage include silverware, camera, stamp and coin collections, jewelry and furs available under an open perils basis. Antiques and fine arts can be insured on an evaluated basis. **Personal property under homeowners coverage is normally covered under an actual cash value basis.** An optional personal property

replacement cost endorsement is available on all property on a replacement cost basis. Four types of property are specifically excluded from replacement coverage under the personal property replacement cost endorsement and they include:

- 1) Antiques and fine arts.
- 2) Collector's items, souvenirs, etc.
- 3) Property that is not in workable condition.
- 4) Articles which are obsolete and are being stored and are not being used.

## **REFRIGERATOR PROPERTY COVERAGE**

The refrigerator property coverage endorsement is for damage done to property which is stored in the freezer or refrigerator of the insured. Losses caused by the interruption of power or electrical service, or by the mechanical failure of the unit are protected. There is normally a \$500 limit on coverage with a \$100 special deductible.

To have simpler language and uniform policies, the **Dwelling 77 Program** was introduced in the 1970's. The original Dwelling 77 Program, as well as its

successor Dwelling '89 program, is **made up of three policy types that make the standard fire policy part of their language, all in one contract. Property is covered on an "anywhere in the world" basis.** It is a "monoline" contract to which endorsements may be added for additional premium.

A "dwelling" is a residential structure which previously was insured by adding a "Dwelling Building & Content Form", or DB & CF, to the Standard Fire Policy. the DB & CF covered property only in the USA or Canada.

**Three policy types are with the Dwelling Program:**

- 1) "The Basic Form" (DP1),
- 2) "The Broad Form" (DP2) and
- 3) "The Special Form" (DP3).

**As the insured moves from basic form to broad form to special form they will find the coverage broadens.** An insured may select an insurance type that varies on coverage as well as premiums payable. Under the dwelling program, dwellings containing 1 to 4 families or apartments and dwellings housing 1 to 5 roomers, or boarders, **are eligible under each of the three policy types for coverage.** A mobile or trailer home which is permanently located may be insured, but only under the basic form (DP1). Townhouses or

"row" house are eligible if a separate structure contains no more than four occupied units. Farm dwellings are not eligible for dwelling coverage.

The Dwelling Form provides **"Replacement Cost Coverage"** - the building is restored at today's cost as long as the insured keeps the coverage amount at least 80% or more of the full replacement cost (DP2 AND DP3 ONLY). However, the DP1 coverage form provides an "Actual Cash Value" basis of recovery and not replacement cost.

The dwelling form is available to a real property owner who is ineligible for a homeowner (HO) policy due to the age of the building, location, value or number of living units. **This coverage form is usually issued to cover non-owner occupied buildings.** The owner of a building housing more than 4 units must seek a commercial form of coverage.

The three dwelling coverage forms are similar to the Homeowners Forms 1,2, and 3, with the following exceptions:

**DWELLING FORMS DO NOT:**

- 1) *cover the peril of theft* (it must be endorsed)
- 2) *cover personal liability* (it is an optional endorsement)
- 3) *cover money* or valuable papers
- 4) have special limits of liability for certain types of personal property
- 5) cover boats (except rowboats and canoes)
- 6) cover property away from the insured premises for more than 10% of the premises limit for all three forms.

**SECTION VII:**  
**OTHER PERSONAL COVERAGE**  
**FORMS AVAILABLE TO THE**  
**INDIVIDUAL**

**REVIEW OF DWELLING FORMS****BASIC FORM (DP1)**

**IT NAMES THE PERILS COVERED** - This insures against fire, lightning and any type of internal explosion. There is no minimum dollar coverage requirement. **There is no landscape coverage with the Basic Form.** Internal explosion means direct loss to insured property due to any explosion occurring in the described property or any other structure containing the insured's personal property **EXCEPT** these exclusions:

*bursting water pipes, electrical arching, rupture or bursting of pressure relief devices, and explosions of steam boilers or steam pipes.*

The basic form may also be purchased with **extended coverage (EC) and vandalism or malicious mischief (VMM)** (for an additional premium) **Extended coverage adds the following perils as covered items under the basic form:** Windstorm or hail, explosion, riot or civil commotion.

**Windstorm and hail means** the direct action of wind or hail including objects hurled through the wind that cause damage because of direct action by the wind. **Exclusions to windstorm and hail** include:

*Frost, cold weather, snow, sleet, ice, rain, sand and dust.*

**"Explosion"** replaces internal explosion coverage when extended coverage is added. Under EC, **explosions are covered** whether they originate **inside or outside** the building. **Excluded** from coverage

*Bursting from water pipes, electrical arching, rupture or bursting or pressure relief devices, and explosion of steam boilers or steam pipes.*

**Riot or civil commotion**, damage due to an assembly of individuals who act in a violent or tumultuous manner, **is broadly covered by EC.** **Aircraft** is covered against damage, including self-propelled missiles and spacecraft.

**Vehicles** are covered for any damage caused by the vehicle to the covered property. Exclusions are

*damages caused by vehicles owned or operated by the insured and damaged fences, driveways and wooden walks caused by any vehicle.*

**Extended Coverage broadens damage due to smoke** by extending coverage to damage by smoke **from any source other than fireplaces** or agricultural smudging or industrial operations as long as damage is accidental and sudden. Volcanic eruption includes loss caused other than by earthquake, land shock waves or tremors.

**Extended Coverage and Vandalism and Malicious Mischief (V&MM) can also be purchased, BUT ONLY if EC was also added.** Vandalism and malicious mischief, or the **intentional damage or destruction to the property of the insured**, is covered. Exclusions which apply under V&MM include

*Loss by pilferage, burglary, larceny or theft, damage to glass unless the glass constitutes part of the building, and loss to a dwelling which is described in the contract if has been vacant for more than 30 days immediately before the loss occurred.*

## BROAD FORM (DP2)

**IT IS ALSO A NAMED PERILS POLICY** - Extended or broadened **coverage** found under the broad form, as opposed to the basic form, **includes everything in the basic form plus three of the extended coverage perils are broadened in scope.** It also **includes landscape coverage.** The three EC perils which are broadened under DP2 include **explosion, vehicle damage, and smoke damage.**

- 1) Explosion under the broad form includes steam boiler explosion.
- 2) Vehicle damage in DP2 covers only excludes damages to fences, driveways and walks when caused by a vehicle owned or operated by an insured or resident. Otherwise such damage is covered when caused by nonresidents as opposed to the basic form which excludes all damages to driveways, fences and walks, no matter who causes it.
- 3) VMM - loss to glass parts of a building are not excluded as in the basic form.

There are **seven new perils which are insured against under the broad form in addition to all those discussed under the basic form.**

1) BURGLARY (COVERS DAMAGE DONE TO THE PROPERTY BUT NOT PROPERTY TAKEN),

2) falling objects - excluding awnings, fences and outdoor equipment.

3) damage done to a building or its contents because of weight from ice, snow, and sleet.

4) freezing of plumbing, heating systems,

5) tearing apart of steam or water systems, air conditioning or fire protective sprinkler systems, or of a household appliance for heating water. but not loss caused by freezing.

6) sudden and accidental electrical current damage

7) accidental discharge of water and steam from plumbing, heating, air conditioning or fire protective sprinkler systems, or of a household appliance. This does not include loss due to continuous leakage or seepage.

Note: the burglar and accidental discharge perils are subject to the 30 day condition concerning vacancy and unoccupancy of the building. **If a building was not occupied or was vacant 30 days before the loss occurred, coverage would be excluded. The freezing**

**peril is voided when there is vacancy/unoccupancy unless reasonable care was taken to heat the building and shut off water supplies.**

### **SPECIAL FORM (DP3)**

#### **- IT IS ALL RISK, NOT NAMED PERIL -**

The special form, or DP3, is **the most comprehensive coverage available under the dwelling and contents policies. The special form covers dwelling and other structures on a all risk basis** for Coverages A and B. Landscape coverage is included.

**All risk means that the perils covered are not specified (NAMED).**

#### ***IF IT IS NOT EXCLUDED, IT IS COVERED***

In order to be excluded from coverage the peril or cause must be specifically listed under the exclusions clause.

Note: under a special form, although there is all risk insurance on dwelling and other structures, **the contents of the dwelling under a special form are not covered under an all risk basis.** Contents are covered on a name peril basis.

Insurance is not provided, under the special form (under coverages A & B) for any of the following: (NOTE THESE EXCLUSIONS)

*1) any property or losses not covered according to the insuring agreement and general exclusions section.*

*2) loss involving collapse other than as provided under other coverages.*

*3) freezing of plumbing, heating, air conditioning or fire protective sprinkler systems, or of a household appliance while the building is vacant/unoccupied or under construction unless reasonable care was taken to heat the building.*

*4) weight of water, including from freezing or thawing doing damage to a fence, paved area, swimming pool, foundation, retaining wall bulkhead, pier, dock or wharf.*

*5) vandalism and malicious mischief when there is 30 or more consecutive days of vacancy.*

*6) when there is seepage or leakage over a period of time from plumbing, heating, air conditioning or fire protective sprinkler systems.*

**7) all gradual and preventable losses such as normal wear and tear, deterioration, latent defects, etc. (the policy is supposed to cover loss from sudden and accidental sources, not loss from preventable or expected sources).**

8) damage due to the discharge, release or escape of pollutants whether gaseous, solid or liquid.

9) settling, shrinking, bulging or expanding of pavements, foundations, floors, walls, roofs or ceilings.

10) loss caused by insects, domestic animals, vermin or birds.

## **THEFT ENDORSEMENTS**

Since Dwelling forms do not offer theft coverage for personal property, the form known as "**Broad Theft Coverage**" (BTC) should be added as an endorsement. BTC insurance provides the same coverage found in the homeowners

Also available is a **Limited Theft Coverage Endorsement**. It provides insurance only to on-premise property. It excludes money, valuable papers, jewelry and furs and silverware.

## **PERSONAL LIABILITY SUPPLEMENT**

The dwelling program allows the purchase of personal liability coverage as an endorsement to the contract. Prior to the 1989 revision, the dwelling contract holder was forced to purchase a separate policy for personal liability.

**The modern approach used for insuring mobile homes is based on a homeowners policy approach.** Under the homeowners approach, mobile homes are considered much the same way as a regular home is treated for insuring purposes. The main change from the automobile approach to the homeowners approach is based on the idea that mobile homes, in general, will increase in price over time rather than depreciate as do cars.

In order for a MOBILE HOME policy to be written, (it is written as an endorsement to a homeowners policy) the MOBILE HOME must be portable, designed for year round living and must not be less than ten feet wide and forty feet in length. Such a requirement eliminates vacation campers from being considered for this policy type.

## COVERAGE

The coverage under mobile homes is described in the declaration section of the contract of coverage A. The MOBILE HOME endorsement changes the definition of dwelling in the homeowner's form to include the MOBILE HOME. It also includes the MOBILE HOME's permanently installed floor coverings, dressers and cabinets, appliances, utility tanks, and any other built-in or attached item of a similar nature.

**Replacement cost coverage is available** when the policy is written for at least 80% of the replacement value. However, the owner could lower the premium cost by selecting an endorsement for coverage on an actual cash value basis. If the owner selects an actual cash value basis, the amount of insurance provided for loss would be based on the value of the MOBILE HOME less any depreciation it has suffered since the point of purchase. Although actual cash value saves premium, it may prove to be a foolhardy choice in the event of total loss.

## ISO MOBILE HOME ELIGIBILITY

In the past, insurance for mobile homes was written with the viewpoint that the MOBILE HOME was

similar to an automobile. Therefore the pricing of insurance for mobile homes, due to the automobile approach, considers the MOBILE HOME as a depreciable asset.

There is a special contract clause relating to loss settlement. Due to the difficulty of MOBILE HOME repair if a part of a series of panels used in the construction of the MOBILE HOME become damaged, the language of the insurance contract in reference to payment, is as follows:

*"The reasonable cost of repairing or replacing the damage part to match the remainder as closely as possible, or the reasonable cost of providing an acceptable decorative effect or utilization as circumstances may warrant".*

The meaning is that if the repairs in the unit are a mismatch, the insurance company will pay for covering, painting, etc. of the unit.

## PERSONAL PROPERTY

The insurance limit on personal property in a MOBILE HOME endorsement is 40% of the coverage A (MOBILE HOME coverage limit amount). In a standard homeowner's policy, you may recall, personal

property is covered at a 50% of the dwelling value basis. The reason that the MOBILE HOME personal property coverage is less than that of a standard homeowner's policy is because so many of the contents, which would otherwise be considered personal property, are built into a MOBILE HOME.

### **ADDITIONAL LIVING EXPENSE**

In the event that the MOBILE HOME becomes damaged and it requires the owner occupants to live elsewhere until an insurance settlement has been created, the amount of additional living expense is equal to 20% of the insured value of the MOBILE HOME. When the automobile approach of writing coverage was used, the additional living expense was \$15.00 per day up to the maximum of 45 days, similar to the auto policy and its clause relating to renting a car when the owned vehicle is damaged.

### **PROPERTY REMOVAL**

The coverage for property removal is \$500.00 and there is an option to purchase an additional limit up to \$2,500.00 (purchased in increments of \$250.00 each). This coverage will pay for any expense of moving the MOBILE HOME when that movement is required for the MOBILE HOME to escape damage from a possible peril which it is insured against.

### **MOVING ENDORSEMENT**

One throwback to the old auto approach to writing MOBILE HOME insurance is for transportation and moving coverage, which is provided with a MOBILE HOME endorsement. The endorsement will extend the policy for an additional 30 days to cover any collision, upsets, stranding or sinking while the MOBILE HOME is moved to different location.

### **LIENHOLDER SINGLE INTEREST**

Many mobile homes are financed by the dealership that sells them, on a time payment basis. When the lender, or lienholder is involved, there is special protection available under the lienholder single interest endorsement. The endorsement will insure the interest of the MOBILE HOME seller only and provide protection to them for loss which arises from any collision, conversion, embezzlement or secretion of the MOBILE HOME by the insured party.

## FLOOD INSURANCE

### *PURPOSE OF THE PROGRAM*

Prior to 1968, flood insurance on real estate was not widely available. In 1968, a law empowering the department of housing and urban development (HUD), established a federally subsidized flood insurance program which made flood insurance available to business and individuals.

The National Flood Insurance Program (NFIP) is under the jurisdiction of the federal insurance administration and is operated through the Federal Emergency Management Agency (FEMA). **Flood policies can be purchased from either NFIP or through private insurance companies who participate the federal program, called the "write-your-own" program.** When flood insurance is purchased from private insurers, the policy is issued on behalf of NFIP and are reinsured at a 100% level against any loss incurred. Likewise, private insurers that participate in the write-your-own program are reimbursed from NFIP for any losses not covered by premiums charged and the investment income that a company receives as a result of those premiums. Whether coverage is written by the private insurance company or through the federal government, it is sold by private insurance agents who will be paid a commission for the sale.

## ELIGIBILITY

Any community that promises to enforce land control measures, which are designed to develop future land projects away from flood prone areas, is eligible under the national flood program. Any governmental bodies that wish approval for the sale of flood insurance must submit a special statement to FEMA which indicates that they would like to be included in the program. Eligibility for insurance for the community rests on the agreement that they will adopt land use and flood control measures to **prohibit new construction in any area where there is a more than 1% chance of flooding on a yearly basis.**

If a community has agreed to adopt the controls that are specified by FEMA, then they are eligible for something called the **"emergency program"**. In the emergency program coverage is available for eligible properties up to special limits and the **premium rates are subsidized by the federal government.** Today, all property including commercial, residential or industrial and agricultural, as well as public buildings, can get emergency program coverage. The **subsidized coverage under the emergency program is for \$35,000 of coverage on single family dwellings and up to \$100,000 on all eligible structures.**

Coverage is available on residential contents for up to \$10,000. On non-residential contents, the contents insurance limit is \$100,000. Premiums for flood insurance written through the emergency program are the same in all eligible cities and towns that utilize the program. Any additional coverages under the regular program however, can vary in cost based on the actuarial loss probabilities in a particular geographical area.

Another program called the **regular program** can be available when a detailed flood risk study has been completed or waived by FEMA and the community adopts flood plain management ordinances. The regular program increases the amounts of coverages available to the residents under this program.

## **RATE MAPS**

The additional amounts of insurance that are available through the regular program are based on actuarial rates and not subsidized rates. Therefore the flood hazard involved will be the basis of the premium rates for the properties in that local geographic area. The maps involved first are called **the flood hazard boundary map** whereas the **official map which details actuarial risk** for any given community is referred to as **firm or flood insurance rate map**.

## **SPECIAL FLOOD HAZARD AREAS**

**The purchase of flood insurance is required in an area designated as a "special flood hazard area" as a condition to obtaining any form a federal financial assistance once a flood occurs.** The definition of a special flood hazard area is a designated land surface within a community in the flood plain which is most likely to experience severe flooding. When the property at issue is not in a special flood hazard area then flood insurance is not required to obtain a loan. Because of the terrible flooding in much of the country in 1993, the national flood insurance reform act of 1994 strengthened compliance requirements for lenders. Today all property in special flood hazard areas requires the purchase of flood insurance be purchased when a lender is making a loan, increasing a loan, extending it or renewing. The coverage must be in existence for the entire term of the loan.

In the event the borrower does not purchase flood insurance within 45 days of receiving notification to do so, then the lender has the authority to purchase flood insurance for the borrower. This law specifically prohibits all federal agencies from approving any financial assistance to any flood victim for reconstruction following a flood if the individual has not purchased flood insurance as required by law.

## RESIDENTIAL COVERAGE

The flood policy provides insurance for coverage A, coverage B and coverage C for debris removal. Flood insurance can be purchased on the dwelling, on the contents or on both dwelling and contents. The limit for debris removal is included within the limit of liability to the insured property, but it is listing in a separate insuring agreement. The residential flood policy uses simplified language which parallels the format of contracts used by private insurers for property insurance.

## INSURING AGREEMENT

Residential flood policies give coverage for direct physical loss by or from flood with the following exact definition appearing in the contract:

*"A general and temporary condition of partial or complete inundation of normally dry land areas from overflow of inland or tidal waters or from the unusual and rapid accumulation of runoff of surface waters from any source".*

The loss which is covered also includes flood related erosion caused by mud slides. The insuring agreement also stipulates that the flood must be a

general condition of the area. There will be no coverage for flood damage for isolated situations (i.e. sewer backup or broken sump pumps in the insured's basement).

## BUILDING COVERAGE

The insuring agreement defines dwelling much like it does in fire policies. Any materials and supplies intended for construction of the building are covered, but only if they're inside a fully enclosed area. There is a 10% coverage for appurtenant structures but only when those structures are fully enclosed. The policy is sold on an actual cash value basis but replacement cost coverage can be purchased for one to four family dwellings that are occupied for at least 80% of the year. Replacement cost coverage also requires that the structure be insured for at least 80% of its replacement cost. Specifically excluded from coverage is landscape including lawns, trees, shrubs and plants. Also excluded would be outdoor swimming pools, fences and water structures. Walks, driveways and any paved surface outside the building are excluded. Certain property in basements is excluded by flood policies such as finished walls, floors ceilings and other improvements.

## CONTENTS COVERAGE

Residential contents maybe insured under a flood policy but the coverage applies to household and personal property which is usual and incidental to the occupancy of the dwelling. The policy holder may extend coverage to include the property of guests or servants who are on the premises. A critical notion in the coverage is that contents are covered against loss by flood only if they're inside a fully enclosed or sheltered building on the premises. This exclusion does not allow for off premises extension. Personal property which could be covered includes things like air conditioning units, portable dishwasher, carpet installed on a finished floor, clothes dryers and clothes washers.

**There is a fairly long list of property which is not covered including money, securities, valuable papers, animals, birds, fish, aircraft, motor vehicles, trailers, watercraft and business property.** There are two other property groups subject to dollar limits including a \$250 aggregate limit for fine arts (which includes paintings and antiques) and a separate \$500 aggregate limit for jewelry, watches, gold, silver, platinum and furs.

**Any tenant improvements or betterments are covered up to 10% of the amount of coverage on the contents**, but this is not an additional amount of insurance.

## REMOVAL

Property can be removed from the premises to protect it from other insured perils for up to 30 days at a new location. The policy does include reimbursing the insured for reasonable expenses for moving the insured's contents to a safe area and put them in temporary storage for a period not exceeding 45 days if the property is in imminent danger of flood. However, the coverage amount for property removal is limited to a \$750 reimbursement with no deductible applied.

## EXCLUSIONS

The usual exclusions of war, nuclear reaction, the operation of building codes and the neglect of the insured to protect and preserve the property are included. There is also an exclusions for damages resulting from power, heating or cooling failure unless such failure results from damage to equipment which is on the premises due to flood. The other exclusions include loss by fire, windstorm, explosion, erosion, earthquake, landslide or other earth movement except for mudslide.

## **DEDUCTIBLE**

The residential flood insurance policy has a deductible which is applied separately to the building and to the contents. Dwellings that are insured under the emergency programs that are located within certain zones where the rates which are used to compute the premium date from before the publication of flood insurance rate map, the deductible is \$750. For all other cases the deductible is \$500. There is also a \$250 deductible applied separately to each building and contents loss for payments for land subsidence, sewer backup or seepage of water. High deductibles are available for lower premium and they range by \$1,000 from \$1,000 up to \$5,000.

## **STARTING AND CEASING COVERAGE**

There is a 30 day waiting period once an application and payment of premium has been made before a flood insurance policy becomes effective, however this 30 day waiting period does not apply when you are initially purchasing flood insurance in connection with taking or extending a loan. Also the waiting period will not apply to the initial purchase of flood insurance when the purchase happens during a 13 month period following the revision or update of a flood insurance rate map. In the event the insurance company cancels the policy for nonpayment of premium, a 20 day

written notice of cancellation is required. If the insured keeps the property, the premium for the current term is fully earned and there would be no premium refund if they decide to drop the insurance. On the other hand, if the insured sells the property any premium which is owed would be returned on a short rate basis.

## **INDIVIDUAL INLAND MARINE COVERAGE**

The homeowners form does a good job of insuring personal property for most individuals, but in some cases it may be important to specifically insure certain items of personal property under an inland marine form. Normally we wish to insure certain types of property that are excluded under the homeowners insurance such as automobiles, recreational motor vehicles or items on which coverage in the homeowners policy is limited.

Coverage on boats and trailers is limited to \$1,000 while the theft peril does not apply to property while it is away from the premises. Theft coverage on jewelry and furs is limited to only \$1,000 per loss. The insured may wish to supplement the homeowners form and provide extra amounts of insurance on specifically scheduled items.

## **FLOATERS**

The word floater originally meant coverage for property while it was away from the insured's premises. The homeowners form does cover personal property while it is anywhere in the world. The floater is used for excess amounts of coverage on specific items that the homeowners policy is inadequate to cover. The notion of the floater is that coverage is on inland marine basis and the property that is covered is mobile by its nature. The floater generally provides coverage on open perils rather than the named scheduled basis.

## **SCHEDULED PERSONAL PROPERTY AS ENDORSEMENT**

The scheduled personal property endorsement to the homeowners contract is an open perils coverage for nine classes of property including the following: furs, jewelry, silverware, golf, camera equipment, fine arts and antiques, stamps, coins and musical instruments.

## **FURS**

The fur floater is very broad coverage with only three basic exclusions including:

- 1) Loss caused by wear and tear or gradual deterioration as well as loss caused by insects, vermin and inherent vice.
- 2) Loss by nuclear radiation or radio active contamination.
- 3) Loss caused by war.

The apparel that is covered has to be a dress pelt of some animal and cannot be a man made fabric. At the very least, it must be trimmed with fur. Although an appraisal of each fur is required before it can be insured, a copy of the sales receipt on a recently purchased fur would be adequate in establishing the value of the fur. Coverage of furs is on a world wide basis and any additional acquired property is automatically insured. This is subject to 25% of the amount of insurance or \$10,000 which ever less is so long as it is reported within 30 days. The other floater, also has the same 25% or \$10,000 which ever is less application. The newly acquired property coverage also applies only to personal jewelry, cameras and musical instruments.

## JEWELRY

The **jewelry floater** provides coverage on also an **open peril basis** with each item scheduled with an amount of insurance that is applied to on an actual cash basis. An appraisal is required or some type of establishment of the cost must be involved. Besides the normal exclusions, the personal jewelry contract has a pair and set clause as a condition. The pair and set clause will not allow collecting for a total loss if one item of a pair is lost or destroyed. In the event one item of the pair or set is in fact destroyed, the loss that is paid is based on a fair proportion of the total value of the set. This is based on the importance of the article involved.

## SILVERWARE

This provides coverage on valuable silverware or silver plated ware and items of the same kind. The coverage is very similar to jewelry. There is no automatic coverage on additionally purchased items.

## GOLF

A golfer's equipment can be insured under a separate policy or covered under a personal property endorsement of the homeowners contract. This will provide coverage for golfing equipment including:

clothing, except for watches and jewelry, golf clubs and any other clothing contained in a locker room in a clubhouse or other building which is used while the game of golf is involved. Eligible property for coverage is very broad and even includes a golf cart. There is open perils coverage for most items and is written on a blanket basis. One exception is the coverage for golf balls is not open perils but is only limited to the perils of fire and burglary for recovery by the insured.

## CAMERA

Cameras are also insured on an open perils basis. Coverage includes: protection for projection machines, movable sound equipment, films, binoculars and telescopes.

## FINE ARTS /ANTIQUES

The fine arts floater covers fine art objects including: antiques, rare manuscripts and statuary items. It is also open perils coverage and has the normal exclusions. **The open perils exclusions include:** wear and tear, **gradual deterioration or inherent vice, insects or vermin** and coverage on fine arts and antiques has three additional exclusions including:

- 1) The breakage of certain fragile articles unless the breakage is caused by specifically named perils.
- 2) **Damaged caused by repairing, restoration or retouching process.**
- 3) Any loss by any cost to the property on exhibition and fair grounds or premises of national or international exhibitions unless the premises are covered by the policy.

The specific types of **perils which are covered** under this floater include:

- 1) Loss caused by fire or lightening.
- 2) Loss caused by explosion, aircraft or collision.
- 3) Loss caused by **windstorm, earthquake or flood.**
- 4) Loss caused by malicious damage or theft.
- 5) Loss caused by derailment or overturn of a conveyance (ie. a train, truck, etc.).

Antiques and fine arts are insured on a valued as opposed to an actual cash basis. This means the insurance company will insure each item based on

value in event of loss. Therefore much care must be given to determining the values. Normally the insurance company will require an appraisal and each item will be scheduled with an amount of insurance that is subject to a percentage limitation relative to an aggregate amount of the schedule involved. Any additionally acquired items must be reported within 90 days and a proper pro-rata addition must be paid.

## STAMPS AND COINS

Since coin and stamp collections can become quite valuable, extra amounts of coverage are desirable under a personal articles floater. Property eligible for stamp coverage includes: postage stamps on an envelope, those which are official, anything dealing with revenue, match and medicine covers, locals, reprints, essays, proofs and other philatelic property owned or in the control of the insured. Coverage is also provided for book, pages and mountings.

Coins which are eligible for coverage include: rare and current coins, medals, paper money, bank notes, tokens of money and other numismatic property that is owned or in the custody or control of the insured. This includes: coin albums, containers, frames, cards and display cabinets.

Both stamps and coins can be insured on a schedule or a blanket basis. Normal exclusions include: damage resulting from fading, creasing, denting, scratching, tearing, thinning, transfer of color or damage as a result of the property being worked on is excluded. Also excluded is mysterious disappearance of individual stamps unless the items are specifically scheduled or mounted in a volume and the page to which the stamp is attached is also lost. Any unintended loss as a result of an automobile is excluded with the exception of the items being shipped by registered mail. There is a policy limit of \$250 on any unscheduled stamp, pair, block or series and \$1,000 on unscheduled numismatic property. If the insured fails to schedule a high valued item then coverage for that item will not exist.

### **MUSICAL INSTRUMENTS**

Musical instruments can be quite valuable and require broad type of coverage under an inland marine contract. The personal property endorsement related to musical instruments is open perils coverage and any acquisitions have to be reported within 30 days with an additional premium paid. One condition unique to this floater includes the fact that the coverage will be provided if the insured agrees that none of the instruments insured will be played for money during

the term of the policy unless it is specifically permitted by endorsement and there is a payment of additional premium.

This condition establishes a difference between the amateur and professional musician for rating purposes. The worst loss will occur with a professional musician rather than an amateur who is not engaged in performing for hire.

### **PERSONAL PROPERTY FLOATER**

Other floaters are available depending on the type of property involved. They include: a separate gun floater, fishing tackles floaters or sporting goods floaters. Specific personal property floaters are available to people who do not own their own home but wish to have open perils coverage on personal property rather than on just special classes of property which can be scheduled. The personal property floater provides a single amount of insurance to cover all unscheduled personal property except for three limitations including:

- 1) A limit of 10% of the amount of insurance applicable to unscheduled personal property for property located at a secondary residence of the insured.

- 2) The maximum collectible for any loss of jewelry or furs is \$250.
- 3) A limit of \$100 for loss money including coin collections with a \$500 limit on accounts, bills, deeds, evidence of debt and other valuable papers.

The personal property floater is open peril coverage and the policy is written with a deductible which can vary from \$100 to \$500. The personal property floater is a luxury contract and is used usually by wealthy people who want the most protection possible and who do not own their own homes. When the wealthy person owns a home, the homeowners form HO15 will provide the same coverage on contents as the personal property floater.

### **WEDDING PRESENT FLOATER**

Since wedding presents can constitute a large value, the wedding present floater is created to provide coverage for gifts received for a temporary period. Coverage exists during gift accumulation while the bride and her new husband are settling into their home. Under the contract, all presents are the property of the bride and the bride must purchase the insurance coverage. The coverage begins when the presents begin to accumulate and coverage exists up to a maximum of 90 days after the wedding. It will

provide open perils coverage and the usual exclusions. Certain types of property are excluded: realty, animals, automobiles, motorcycles, aircraft, bicycles, boats, money, notes, securities and stamps.

### **WATERCRAFT**

Since the homeowners policy provides only \$1,000 for watercraft and equipment, the need for additional coverage is required. The boatowner will need one of the types of watercraft policies available because the homeowners contract only covers a very limited amount of liability applying to smaller watercraft. The two basic types of policies available include: the **boatowner policy and the yacht policy** which is used to insure very large boats. The difference between the boat policy and the yacht policy has become minimized over the years but yacht policies are considered ocean marine coverage. The boatowners policy is developed to combine liability coverage with the inland marine form. This course will emphasize the boatowners policy for study purposes.

### **BOATOWNER POLICY**

The boatowner policy is a package contract and is quite similar to the auto policy because it provides coverage for concepts of liability, physical damage, medical payments and uninsured watercraft. The

boatowners policy available in most markets includes: Section I for physical damage coverage and Section II for liability coverage.

### **PHYSICAL DAMAGE COVERAGE (Section I)**

Coverage A of the boatowners policy provides for physical damage on the boat. **Coverage is on an actual cash value basis for scheduled boats, motors, equipment and accessories manufactured for marine use as well as any trailers described in the declarations.** Coverage is based on an open perils concept and exclusions which include: wear and tear, gradual deterioration, inherent vice and mechanical breakdown. Depending on the company the policy is held with, other exclusions can include:

- 1) when a boat is used to carry persons for hire
- 2) while the boat is rented to others
- 3) while the boat is being operated in a race or speed contest.

When it comes to **valuing the boat, it can vary from company to company.** An agreed value basis means that the face amount of insurance is payable in the event of loss. Other options include: replacement cost coverage which is similar to replacement cost under a homeowners form.

### **LIABILITY (Section 2)**

The three types of coverage under the boatowners policy in Section 2 are quite similar to the coverages of a personal auto policy including:

**1) Watercraft** - *Watercraft coverage is protection up to a specified limit for any claim or law suit against an insured for damages caused by the insured to another's body or property. The party who is considered to be an insured under this coverage is quite broad and includes: family members and other people who are operating the watercraft with the permission of the insured. The liability exclusions include:*

- a) Bodily injury or property damage, which is intentional.
- b) Liability of any person who uses the watercraft without the permission of the owner.
- c) Any damage to the property owned by or in the care, custody or control of the insured.
- d) Injury to persons who are eligible to receive benefits under workers compensation claims.
- e) The liability of a person engaged in the business of selling, storing, moving or repairing a watercraft.

Depending on the company, exclusion might include: any sailboat or watercraft that is used in an official race or speed test. Two other normal exclusions for watercraft liability would include: war and nuclear exclusions.

**2) Uninsured boaters** - The uninsured watercraft coverage is available as an option under the boatowners policy. The normal amount of coverage is \$10,000 for any insured or family member who suffers bodily injury caused by an uninsured boater. This uninsured boaters coverage is very similar to the automobile insurance coverage for uninsured motorist coverage which is discussed in a previous section.

**3) Medical Payments** - The medical payments coverage will pay for medical expenses resulting from boating accidents when a person which includes the named insured and family members are injured "in, upon, getting into or out of the insured watercraft". Some policies even include medical payments coverage for an individual who is water skiing.

### **TERRITORIAL LIMITATIONS**

Policies normally limit the watercraft and insured only in specified territories. Vary broad policies will normally cover a watercraft which is operated on any

inland body of water within the continental United States and Canada, including coastal waters up to a limit of 10 to 25 miles. On the other hand, very narrow policies provide coverage only on a specified body water or only within a very narrow boundary around a particular area. Between broad and narrow coverage, exist policies that will provide coverage to inland lakes or in certain areas with the option to extend coverage to certain areas including: the Carribean, Bahamas, etc., if the boatowner frequents these locals. However many policies will not provide coverage for offshore waters including the Gulf of Mexico.

### **SELECTING THE PROPER COVERAGES**

#### **ANALYZING PRICE**

In addition to price differences between companies there can be a difference in insurance costs based on the elements of risk to the individual insured's property. Normally a premium rate is based on a unit of insurance and is generally based on a cost per \$100 or \$1,000 of coverage. The rate per \$100 or \$1,000 is then multiplied by the amount of insurance purchased. For real property, much of the premium rate will be based on the type of construction. For instance, fire insurance for a wood building would have a greater cost than for a building built with brick.

Rates can also be different based on the actual actuarial experience of each location. Fire protection can vary from city to city and **the Insurance Services Office has an evaluation of each fire department and water supply on a rating from 1 to 10. Number 10 is the highest rated with number 1 being the lowest rated.** Dwelling property and homeowners programs have rates based on three main factors including: type of construction, fire protection of the city and the number of families living at the location. With a homeowners program the same three considerations exist as in the dwelling property but the homeowners contract has the concept of package policy using indivisible premium by which the premium is the cost of the entire package without regard to a different premium based on various sections of the contract.

### DECIDING ON FORMS

When evaluating a homeowners policy and considering the difference between a HO2 versus a HO3, it would seem silly economically to choose the HO2. For a slight amount of extra premium, the HO3 will provide open perils coverage rather the named perils coverage associated with HO2. In the event an insured just cannot afford this slight extra premium, it

should be suggested to select a higher deductible under the homeowners contract and elect to purchase the HO3. It is commonly accepted that an HO3 with a higher deductible is a much more desirable contract than a HO2 with a smaller deductible. The reason for this is that an insured should elect much broader coverage and have a higher deductible as opposed to having a lower deductible on more narrow coverage.

### CHOOSING THE RIGHT COVERAGE FOR THE PROPER RISKS

Most people, when purchasing insurance on their dwelling and its contents, make a mistake on the amount of insurance coverage they purchase. **A dwelling should be insured based on its replacement cost.** If it's an older building, developing the concept of replacement cost can be more complicated than if it's a relatively new building. When older property is involved, the replacement cost can be easily determined with the aid of a **replacement cost estimator** which is available from various insurance companies and agents. The replacement cost estimator is **easy to use and provides a reasonable value of an insured's dwelling and applying stated cost factors to the various items of construction.**

When considering the purchase of replacement cost coverage it is very common for people to purchase at least 80% of the full replacement cost to avoid a co-insurance penalty. However, it is ideal for the insured to purchase 100 % of replacement cost value in addition to purchasing an inflation guard endorsement. Coverage based on these two concepts will result in obtaining enough insurance in the event of total loss.

**Contents coverage in a homeowners contract is equal to 50% of the value of the dwelling.** Whether or not this is adequate coverage depends on the individual insured involved. In the event the insured has items of high value they should make arrangements to avoid being uninsured in the event of a big loss. If actual cash value is applied to contents coverage then perhaps a conversion to replacement cost is desirable. In the event the insured has specific items of personal property that are not covered under their homeowners policy or have very minimal coverage, they should definitely either seek to insure them with the appropriate endorsements or increase the amount of coverage available. Another endorsement that should be considered is earthquake damage assumption. For a very limited amount of money in most areas, the catastrophe of an earthquake can be covered for a very minimal premium.

## **REAL ESTATE TITLE INSURANCE**

When a person purchases real estate, the key issue is whether or not the title being conveyed to the new purchaser is free and clear of any defects. The new purchaser can hire an attorney to search the title going back many years to see if there are any problems with the conveyance. However if the attorney is not negligent and there is a forged document in the title history, the lawyer would be free from negligence. He would not held liable.

Since all real property, encumbrances, leans or easements are usually shown in public records, it is fairly easy to study various real estate abstracts to see whether or not clear title exists. Once again however, if fraud is involved, it may not be readily ascertainable that the title is not clear.

Title insurance companies exist within limited territories to provide insurance against the possibility that a title is not completely clear from encumbrances. The title insurance has an abstract plan available for reviewing whether or not title to a property is good. The title company lists any defects in the title and a schedule and will not cover these defects. However, **any undiscovered defects in the title will result in the indemnification to the insured for any loss.**

Title insurance is different from other insurance because **it covers losses which occurred in the past rather than those that might occur in the future.** When undiscovered defects later cause financial loss to an insured the title company will indemnify the insured for the loss. The insurance company also agrees to defend a buyer of the property, in the event legal action is later taken against them, in connection with any loss that is not specifically excluded under the title policy. The **policy coverage period is indefinite** and only ends when the property is sold to a new party. *The party with the best title will be awarded the property in a dispute and if that is not the policyholder he must move and accept the cash equivalent in exchange for leaving the real property.*

Another system that exists as an alternative to title insurance is called the **Torrens system.** Torrens refers to a system developed by Bob Torrens of Australia. Under a Torrens system, the purchaser has the vested right to property. The purchaser pays a fee and it is deposited into a common fund. If another party later shows that they have a better claim to the property than does the existing owner, then the person making the claim is paid for their loss out of the fund, but the title remains with the person who has registered their ownership under the Torrens system. Many critics of title insurance believe that Torrens laws are far superior in granting a clear title and should be spread throughout all fifty states. Although a Torrens law exists in fifteen

states, only four states actually have authorized the use of the system including: Hawaii, Illinois, Massachusetts and Minnesota.