

## **Session 8: Legal Principles and Analysis of Insurance Contracts**

1. Jake borrowed \$800,000 from the Gateway Bank to purchase a fishing boat. He keeps the boat at a dock owned by the Harbor Company. He uses the boat to earn income by fishing. Jake also has a contract with the White Shark Fishing Company to transport tuna from one port to another.
  - a. Do any of the following parties have an insurable interest in Jake or his property? If an insurable interest exists, explain the extent of the interest.
    1. Gateway Bank
    2. Harbor Company
    3. White Shark Fishing Company
  - b. If Jake did not own the boat but operated it on behalf of the White Shark Fishing Company, would he have an insurable interest in the boat? Explain.
2. Ashley purchased a dining room set for \$5000 and insured the furniture on an actual cash value basis. Three years later, the set was destroyed in a fire. At the time of loss, the property had depreciated in value by 50 percent. The replacement cost of a new dining room set at the time of loss was \$6000. Ignoring any deductible, how much will Ashley collect from her insurer? Explain your answer.
3. Nicholas owns a laptop computer that was stolen. The laptop cost \$1000 when it was purchased five years ago. A similar laptop computer today can be purchased for \$500. Assuming that the laptop was 50 percent depreciated at the time the theft occurred, what is the actual cash value of the loss?
4. Megan owns an antique table that has a current market value of \$12,000. The table is specifically insured for \$12,000 under a valued policy. The table is totally destroyed when a tornado touches down and damages Megan's home. At the time of loss, the table had an estimated market value of \$10,000. How much will Megan collect for the loss? Explain your answer.
5. A drunk driver ran a red light and smashed into Kristen's car. The cost to repair the car is \$8000. She has collision insurance on her car with a \$500 deductible.
  - a. Can Kristen collect from both the negligent driver's insurer and her own insurer? Explain your answer.
  - b. Explain how subrogation supports the principle of indemnity.
6. One requirement for the formation of a valid insurance contract is that the contract must be for a legal purpose.
  - a. Identify three factors, other than the legal purpose requirement, that are essential to the formation of a binding insurance contract.
  - b. Explain how each of the three requirements in part (a) is fulfilled when the applicant applies for an auto insurance policy.
7. Nicole is applying for a health insurance policy. She has a chronic liver ailment and other health problems. She honestly disclosed the true facts concerning her medical history to the insurance agent. However, the agent did not include all the facts in the application. Instead, the agent stated that he was going to cover the material facts in a separate letter to the insurance company's underwriting department. However, the agent did not furnish the material facts to the insurer, and the contract was issued as

standard. A claim occurred shortly thereafter. After investigating the claim, the insurer denied payment. Nicole contends that the company should pay the claim because she answered honestly all questions that the agent asked.

- a. On what basis can the insurance company deny payment of the claim?
  - b. What legal doctrines can Nicole use to support her argument that the claim should be paid?
8. Michael owns a small plane that he flies on weekends. His insurance agent informs him that aircraft are excluded as personal property under his homeowners policy. As an insured, he feels that his plane should be covered just like any other personal property he owns.
  - a. Explain to Michael the rationale for excluding certain types of property, such as aircraft, under the homeowners policy.
  - b. Explain some additional reasons why exclusions are present in insurance contracts.
9. A manufacturing firm incurred the following insured losses, in the order given, during the current policy year.

| <i>Loss</i> | <i>Amount of Loss</i> |
|-------------|-----------------------|
| A           | \$ 2500               |
| B           | 3500                  |
| C           | 10,000                |

How much would the company's insurer pay for each loss if the policy contained the following type of deductible?

  1. \$1000 straight deductible
  2. \$15,000 annual aggregate deductible
10. Stephanie owns a small warehouse that is insured for \$200,000 under a commercial property insurance policy. The policy contains an 80 percent coinsurance clause. The warehouse sustained a \$50,000 loss because of a fire in a storage area. The replacement cost of the warehouse at the time of loss is \$500,000.
  - a. What is the insurer's liability, if any, for this loss? Show your calculations.
  - b. Assume that Stephanie carried \$500,000 of property insurance on the warehouse at the time of loss. If the amount of loss is \$10,000, how much will she collect?
  - c. Explain the theory or rationale of coinsurance in a property insurance contract.
11. Andrew owns a commercial office building that is insured under three property insurance contracts. He has \$100,000 of insurance from Company A, \$200,000 from Company B, and \$200,000 from Company C.
  - a. Assume that the pro rata liability provision appears in each contract. If a \$100,000 loss occurs, how much will Andrew collect from each insurer? Explain your answer.
  - b. What is the purpose of the other-insurance provisions that are frequently found in insurance contracts?

12. Assume that a \$300,000 liability claim is covered under two liability insurance contracts. Policy A has a \$500,000 limit of liability for the claim, while Policy B has a \$125,000 limit of liability. Both contracts provide for contribution by equal shares.
  - a. How much will each insurer contribute toward this claim? Explain your answer.
  - b. If the claim were only \$50,000, how much would each insurer pay?
13. Ashley has an individual medical expense insurance policy with a \$1000 calendar-year deductible and a 20 percent coinsurance clause. Ashley had outpatient surgery to remove a bunion on her foot and incurred medical bills of \$10,000. How much will Ashley's insurer pay? How much will Ashley have to pay?
14. The Lincoln Saltdogs is a professional minor league baseball team in the American Association league. The clubhouse is insured for \$600,000 under a commercial property insurance policy with an 80 percent coinsurance clause. The current replacement cost of the clubhouse is \$1 million. After a playoff game for the league championship, a whirlpool tub for the players shorted out, and a fire ensued. The clubhouse sustained a \$100,000 fire loss. Ignoring any deductible, how much will the team's insurer pay for the loss?