

## PROPERTY INSURANCE--INSURABLE INTERESTS, PROPERTY, AND CAUSES OF LOSS (35-1)

EOs 1+2. A person has an **INSURABLE INTEREST** in property if it provides him monetary gain *or* if its destruction would cause him to suffer a monetary loss.

An insured must have an insurable interest in property *at the time of loss*.

### Purposes of the insurable interest requirement:

1. to indemnify people with insurable interest for their lost interests;
2. to prevent wagering on losses by removing the possibility of gain; *and*
3. to deter fraud and intentionally caused losses.

*[Insurance is a **contract of indemnity**, which means the insured is entitled to payment **only** to the extent of the financial loss actually suffered.]*

### Types of insurable interests that may exist in property:

#### I. Ownership interests

##### A. Personal ownership--

1. **joint tenants** (two or more owners, each with full interest in property);
2. **tenancy by the entirety** (joint tenant spouses);
3. **tenants in common** (two or more owners, each with a distinct fractional interest); *and*
4. **life tenant** (person entitled to use and possession of the property for rest of his life).

##### B. Business ownership--

1. **sole proprietorship**--One person owns the business assets and is liable for the debts.
2. **partnership**--Two or more people share ownership, profits, and losses of the business.
3. **corporation**--A separate legal entity owns the business and shields its owners' other assets from liability for losses.  
Stockholders may have the value of their shares reduced to zero, but the **corporate veil** protects their other personal assets.
4. **limited liability corporation**--A separate legal entity that combines the limited liability of a corporation with the pass-through taxation of a partnership owns, in fact, is the business.

Property owners should be listed on the insurance policy as named insureds.

#### II. Occupant interests--a tenant/lessee's **use value of property** (benefit derived from use) including its use value of **improvements and betterments** (real property owned by the real estate owner, but paid for by the lessee).

Tenants often insure their interests by carrying coverage only on their personal property.

Tenants usually let the landlord insure the building.

But, some leases require the tenants to insure the building and to list their landlords as additional insureds.

#### III. Custody interests--

- A. **bailees**--possessors for a limited time for a specific purpose such as repairmen or cleaners;
- B. **consignees**--holder of others' property for sale;
- C. **common carriers**--transporters of others' property for hire; and
- D. **trustees**--holders of legal title for the benefit of another. All have insurable interests to the extent of any lost fees or charges and possible legal liability to the owner for damage to the property.

*There are specific policies designed for common carriers, for bailees' legal liability, **and** for the interests of both bailees and property owners. Any trustee with long-term responsibilities should be named on the policy as either a named insured or an additional insured.*

#### IV. Secured interests--

- A. **Mortgagees**--have insurable interests in real property to the extent of the unpaid balances on the loans.

- B. **Lienholders**--have insurable interests in real or personal property created voluntarily or by operation of law.
- C. **Purchase money security interests**--are liens on real or personal property in the amount of the loan used to purchase the property.

**The mortgage clause** protects the rights of named mortgagees.

Lienholders, assignees (see below), and other security interest holders can protect themselves by appearing on the policy as additional insureds.

- V. **Assignees**--An insured may *not* assign his policy rights *before* a loss. After a loss, an insured often assigns his rights to the policy proceeds to an **assignee**--usually the contractor hired to repair the damage.

EO 3. **REAL PROPERTY** includes land and attached buildings--what you'd leave if you moved.

**PERSONAL PROPERTY** includes tangibles such as merchandise and personal effects and intangibles such as copyrights--what you'd take if you moved.

**Different treatments of real and personal property insurance:**

1. **Overlapping coverage**--Personal property is movable and is more likely to be covered by more than one policy.
2. **Valuation**--Personal property is usually valued at actual cash value. Real property is usually valued at replacement cost.
3. **Coinsurance--Coinsurance clause** requires insurance greater than a specified percentage of the insured value of the property, else the insured shares the loss with the insurer. Coinsurance is usually applied to real property, sometimes applied to personal property, and almost always applied to each separately--hence the need to distinguish between real and personal property as defined in the policy.

A **FIXTURE** (building fixture) is personal property that is so attached or adapted to real property that it becomes part of the real property. **Factors in defining fixtures:** permanent physical attachment to real property, adaptation to or incorporation as an integral part of the building, and owner's intent.

**TRADE FIXTURES** are personal property installed for use in a business (shelves, display cases) to serve the business.

**IMPROVEMENTS AND BETTERMENTS** are fixtures added by a tenant in which the tenant has a use interest. The lease provides whether the betterments can be removed by the tenant or become the landlord's property. The tenant's use interest might be covered under the tenant's policy, the landlord's policy, or both.

Unasked EO. **SIX QUESTIONS IN DETERMINING COVERAGE FOR A GIVEN LOSS:**

1. **Is coverage verified?**--Was the policy was in force on the date of loss?  
Is the location covered by the policy?
2. **Was the loss was a direct physical loss?**
  - a. **Direct loss** results immediately and proximately from an insured peril without any intervening causation.  
**Indirect loss** results from loss of use of tangible property and includes loss of profits, earnings, and rents as well as increased expenses such as overtime, overnight deliveries, and renting a competitor's facilities.
  - b. **Physical loss** involves physical damage to, destruction of, or disappearance of property.  
**Nonphysical loss** involves nontangible or financial loss.
3. **Was the loss caused by a covered peril?** [EOs 5 + 8.]
4. **Do any additional coverages apply?** [EO 7.]
5. **Do any exclusions apply?** [EO 9.]
6. **Have all policy conditions been met?** [Assignment 2, EOs 7 to 10.]

EO 4. **THE EVOLUTION OF COVERED PERILS:**

1. **Original**--The first policies covered *only* buildings for *only* fire. Lightning was added later.
2. **Extended coverage**--In the late 1930s and early 1940s, the Extended Coverage Endorsement (**ECE**) added seven additional perils: windstorm, hail, explosion, riot or civil commotion, vehicles, aircraft, *and* smoke.
3. **Broad form coverage**--The Broad Form Endorsement included the Extended Coverage perils *plus* vandalism and malicious mischief; glass breakage; falling objects; building collapse; damage from a steam or hot water heating system; accidental discharge of water or steam; freezing of plumbing, heating, or air conditioning systems or appliances; weight of ice, snow, or sleet; *and* artificially generated electricity.
4. **Special-form coverage**--Inland marine underwriters developed a Special Form Endorsement that insured “against all risks of physical loss to the property”.  
The current Special Form Endorsement and special-form homeowners policies insure “against risks of direct physical loss”.  
The word “all” was eliminated from “all risks” policies in response to court rulings that extended coverage beyond insurers’ intents.

EOs 5 + 6. **SPECIFIED PERILS POLICIES** insure *only* losses caused by listed, named perils that are *sometimes* defined. Any peril *not* listed as an insured peril is *not* covered by the policy.  
The *insured* has the burden of proving an insured peril caused the loss.

**SPECIAL-FORM POLICIES** insure “against risks of *direct loss* to property” and cover all losses *not* specifically *excluded or limited* by the policy.  
The *insurer* has the burden of proving there is no coverage.

EO 8. **SPECIFIC INSURED CAUSES OF LOSS UNDER PROPERTY INSURANCE POLICIES:**

1. **FIRE**--is the rapid oxidation of combustible material, producing heat and flame.  
**A friendly fire** is deliberately created in a place designed to contain fire.  
**A hostile fire** is any other fire. The fire peril includes hostile, but *not* friendly, fire.
2. **LIGHTNING**--includes direct hits (blast and fire damage), near misses (interference with electrical equipment), and ground surges (damage to wiring and appliances).  
Ground surge lightning poses difficulty for adjusters because it usually leaves no evidence other than damage to electrical equipment. Lightning can cause damage other than fire.  
**Exclusions:** cost of bringing wiring up to code, wear and tear for shorted out wire, and, especially, off-premises power failure. Resulting fire damage is covered under the fire peril.
3. **EXPLOSION**--is the sudden and violent release of internal pressure (air or gas) with bursting and noise. An explosion can occur without fire.
4. **WINDSTORM**--refers to wind velocity with sufficient force to cause damage.  
The windstorm peril does *not* cover wave or flood damage from a hurricane or other severe storm.
5. **HAIL**--consists of hard, ice pellets that cause damage (usually dents) upon impact.  
Sleet, freezing rain, and icy snow are *not* considered hail.
6. **SMOKE**--must be both “sudden” and “accidental”. Smoke does *not* include accumulated damage or smoke damage from agricultural or industrial operations.  
Smoke damage from a friendly fire *is* covered *if* the smoke is *both* sudden *and* accidental.
7. **VEHICLE DAMAGE**--varies depending on the policy form. Some policies exclude damage caused by any insured’s vehicle. Most policies require physical contact with the vehicle.
8. **AIRCRAFT**--includes airplanes, helicopters, self-propelled missiles, and spacecraft.  
The aircraft peril also includes loss from objects falling from aircraft.
9. **RIOT OR CIVIL COMMOTION**--involves a violent, unlawful breach of peace by three or more persons assembled together. Rioters may cause fire, breakage, theft, looting, and vandalism.

10. **VANDALISM OR MALICIOUS MISCHIEF**--is the willful, malicious, *intentional* destruction of property by a person. Intent is established by the circumstances of the loss. Vandalism coverage is suspended for vacant property.
11. **THEFT**--is the taking of personal property with the intent to deprive its owner. Homeowners policies provide substantial coverage for theft, but the BPP provides *either no* coverage *or* limited coverage.
12. **FALLING OBJECTS**--cause damage that is often covered under the vandalism, windstorm, aircraft, or lightning perils. Other loss is covered *only* under a special-from policy or a policy in which fallings objects is a specified peril. Loss to inside property is excluded *unless* the falling object first damages the roof or walls.
13. **WEIGHT OF SNOW, ICE, OR SLEET**--covers *weight* only. This peril is related to the collapse coverage.
14. **WATER DAMAGE**--includes *only* damage by water escaping from broken pipes or appliances. This peril *excludes* constant seepage, mudslides, flood, wave damage, and sewer backup.
15. **GLASS BREAKAGE OR DAMAGE**--applies *only* to glass that is part of the real property and is often subject to dollar limitations. Glass damage caused by any *other* specified peril is covered under *that* peril without regard to the glass-breakage peril. Most property policies allow the replacement of glass with safety glazing *if* required by law or ordinance.
16. **COLLAPSE**--is the sudden falling down or caving in of a building or portion of a building caused by the listed perils, hidden decay, hidden insect or vermin damage, weight of people or property, or defective materials or construction. Collapse is an insured peril in older insurance forms, but is included as an additional coverage in current personal and commercial insurance forms. *Collapse does not include* a building in danger of falling down; parts of a building standing after another part has collapsed; *or* mere cracking, leaning, sagging, settling, bulging, etc.
17. **VOLCANIC ACTION**--includes direct loss caused by *airborne* ash and dust, shock waves, or lava. Any volcanic action occurring within a seven-day period is considered a single occurrence.

EO 7. **DEFINITIONS** indicate the scope of the specified perils in the specified perils forms. Anything *not* contained within the definition of a specified peril is *not* part of the peril and is *not* covered. **Exceptions from definitions** provide a detailed list of what is *not* considered part of the peril, often *adding* coverage.

**ADDITIONAL COVERAGES** provide

1. **supplements to limits**--increases in the available limit for certain coverages;
2. **new types of coverage**--coverage different from the main coverages; *and*
3. **reinstatement of coverage**--that was otherwise eliminated by exclusions.

EO 9. **The typical REASONS FOR EXCLUSIONS from coverage:**

1. **Uninsurable perils**--such as war and nuclear hazards, due to the chance of wide-spread loss, the difficulty of buying reinsurance, the unpredictability of events, and the catastrophe potential.
2. **Gradual, inevitable physical hazards**--wear and tear; decay; settling or cracking of paved areas or walls; and damage by birds, vermin, or pets.
3. **Moral hazard**--losses caused by the insured's active inducement of loss.
4. **Morale hazard (aka attitudinal hazard)**--losses caused by the insured's passive indifference to loss.
5. **Duplicate coverage**--so each exposure is insured under the most appropriate policy for that particular exposure.
6. **Specialized coverage**--for perils that require special underwriting such as flood, nuclear hazard, crime, and earthquake.

## **EIGHT COMMON EXCLUSIONS IN PROPERTY POLICIES:**

1. **Ordinance or law**--encompassing the increase in construction costs or demolition costs resulting from the enforcement of *any* law
  - a. regulating any building *or*
  - b. affecting its value *or*
  - c. related to cleanup of debris after a loss.However, the HO-3 provides limited coverage for increased costs due to ordinance or law.  
**To estimate the amount of the increased costs, the adjuster completes two estimates:**
  - a. one estimate to rebuild or repair as the building existed pre-loss *and*
  - b. one estimate to rebuild or repair in compliance with the code.
2. **Earth movement**--including volcanic shock waves or tremors, landslide, mine subsidence, and mudflow whether caused by man, animals, or nature.
3. **Water damage**--any water at or below ground level.
4. **Power failure**--*but* power failure *is* covered *if* caused by an insured, *on-premises* loss.
5. **Neglect**--Simply, the insured must try to save and protect his property after a loss (as if he had no insurance).
6. **War**--including undeclared and civil war, warlike governmental actions, revolution, and rebellion.
7. **Nuclear hazard**--*but* resulting fire damage *is* covered.
8. **Governmental action**--destruction or seizure of the dwelling, other structures, or personal property *unless* action was taken to prevent the spread of fire.

EO 10. **CONCURRENT CAUSATION** is a single loss caused by two or more separate perils, acting either simultaneously or concurrently.

The problem arises when one of the perils is covered and the other is not.

Insurers try to avoid the concurrent causation problem by inserting wording excluding perils “regardless of any other cause or event contributing concurrently or in any sequence to the loss”.

Our insurance industry interprets that wording to exclude losses caused by excluded perils without having to determine the predominant cause.

### **Three approaches courts use when considering concurrent causation:**

1. **Efficient cause approach**--If the loss is caused by *both* a covered peril *and* a non-covered peril, the loss is covered *if* the “dominant” or “efficient” cause was a covered peril.  
**For a specified-perils policy, the insured** must prove the covered cause of loss was the dominant cause.  
**For a special-form policy, the insurer** must prove the policy excluded the dominant cause.
2. **Liberal approach**--The entire loss is covered *if either* of the causes is a covered peril.  
**For a specified-perils policy, the insurer** must rebut the insured’s evidence that the covered cause of loss contributed to the loss *and* prove the dominant cause was excluded.  
Courts have *not* fully addressed the issue of burden of proof for special-form policies.
3. **Conservative approach**--If a covered peril and a non-covered peril combine to cause the loss, then the loss is *not* covered.  
**For a specified-perils policy, the insured** must prove a covered cause of loss was the dominant cause, *but* the insurer may show that an excluded or non-covered case contributed to the loss.  
Courts have *not* fully addressed the issue of burden of proof for special-form policies.

*[The original concurrent cause loss involved a dam that was incompetently designed and constructed by the government in California. When it gave way and washed away many homes downstream, insurers pointed to the flood exclusion and denied coverage under their HO-3, “all risks” policies.*

*The California court held that there was coverage because incompetent government was not an excluded peril although flood was an excluded peril.*

*Of course, I believe, that court in its construction of the policy was also incompetent.]*